



October 2017

# U.S. TERRITORIES

## Public Debt Outlook

# GAO Highlights

Highlights of [GAO-18-160](#), a report to Congressional Committees

## Why GAO Did This Study

The United States has five territories: Puerto Rico, American Samoa, CNMI, Guam, and USVI. The territories, like U.S. states in some cases, borrow through financial markets. Puerto Rico in particular has amassed large amounts of debt, and defaulted on billions of dollars of debt payments. In response to the fiscal crisis in Puerto Rico, Congress enacted and the President signed the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA) in June of 2016, which established an Oversight Board with broad powers of budgetary and financial control over Puerto Rico and requires GAO to study fiscal issues in all five U.S. territories.

In this report, for each territory for fiscal years 2005-2015, GAO examined (1) trends in public debt and its composition, (2) trends in revenue and its composition, (3) the major reported drivers of the territory's public debt, and (4) what is known about the ability of each territory to repay public debt.

GAO analyzed the territories' single audit reports; interviewed officials from the territories' governments, ratings agencies, and subject matter experts; and reviewed documents and prior GAO work.

## What GAO Recommends

GAO is not making recommendations in this report.

View [GAO-18-160](#). For more information, contact Susan J. Irving at (202) 512-6806 or [irvings@gao.gov](mailto:irvings@gao.gov), or David Gootnick at (202) 512-3149 or [gootnickd@gao.gov](mailto:gootnickd@gao.gov).

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## What GAO Found

**Puerto Rico:** Between fiscal years 2005 and 2014, the latest figures available, Puerto Rico's total public debt outstanding (public debt) grew from \$39.2 billion to \$67.8 billion, reaching 66 percent of Gross Domestic Product (GDP). Despite some revenue growth, Puerto Rico's net position was negative and declining during the period, reflecting its deteriorating financial position. Experts pointed to several factors as contributing to Puerto Rico's high debt levels, and in September 2016 Puerto Rico missed up to \$1.5 billion in debt payments. The outcome of the ongoing debt restructuring process will determine future debt repayment.

**American Samoa:** American Samoa's public debt more than doubled in fiscal year 2015 to \$69.5 million, but remained small relative to its economy, with a debt to GDP ratio of 10.9 percent. American Samoa's debt was primarily used to fund infrastructure projects. Between fiscal years 2005 and 2015, revenues grew and the government's net position was positive and generally improving. GAO previously reported that American Samoa relies heavily on the tuna processing and canning industry. Disruptions in this industry could affect its ability to repay debt.

**Commonwealth of the Northern Mariana Islands (CNMI):** CNMI's public debt declined from \$251.7 million to \$144.7 million between fiscal years 2005 and 2015, decreasing CNMI's debt to GDP ratio to 16 percent. Most of CNMI's debt was used to refinance prior debt and fund infrastructure projects. Despite revenue growth since fiscal year 2011, CNMI's net position was negative and generally declining during the period. GAO previously reported that labor shortages may affect GDP. This could impede CNMI's ability to repay debt in the future.

**Guam:** Between fiscal years 2005 and 2015, Guam's public debt more than doubled from almost \$1 billion to \$2.5 billion, with a debt to GDP ratio of 44 percent for fiscal year 2015. Most of Guam's debt was used to comply with federal requirements and court orders. Revenue grew during this period, and net position fluctuated significantly, with a negative balance in fiscal year 2015. Despite recent and expected economic growth, GAO found that large unfunded pension and other post-employment benefit (OPEB) liabilities may present a risk.

**U.S. Virgin Islands (USVI):** Between fiscal years 2005 and 2015, USVI's public debt nearly doubled, reaching \$2.6 billion and a debt to GDP ratio of 72 percent. Since 2010, most of USVI's debt was used to fund general government operations. Revenue remained stagnant and net position was negative and declining during the period, reflecting a deteriorating financial position. While USVI holds a year's worth of debt service payments in reserve, GAO found that economic uncertainty and looming government pension fund insolvency by 2023 may hamper repayment. In early 2017, USVI was unable to access capital markets to issue new debt at favorable rates. Although the government adopted a financial plan intended to reduce expenditures and increase revenue, the plan does not address USVI's significant unfunded pension and OPEB liabilities and it is unclear whether the plan will produce the intended level of savings.

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## Abbreviations

CNMI	Commonwealth of the Northern Mariana Islands
EITC	Earned Income Tax Credit
GASB	Governmental Accounting Standards Board
GDP	Gross Domestic Product
GNP	Gross National Product
OIA	Office of Insular Affairs
OPEB	Other Postemployment Benefits
PROMESA	Puerto Rico Oversight, Management, and Economic Stability Act
USVI	United States Virgin Islands

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October 2, 2017

The Honorable Lisa Murkowski  
Chairman  
The Honorable Maria Cantwell  
Ranking Member  
Committee on Energy and Natural Resources  
United States Senate

The Honorable Rob Bishop  
Chairman  
The Honorable Raul Grijalva  
Ranking Member  
Committee on Natural Resources  
House of Representatives

The United States has five territories—Puerto Rico, American Samoa, the Commonwealth of the Northern Mariana Islands (CNMI), Guam, and the U.S. Virgin Islands (USVI)—that are permanently inhabited and have elected governors, territorial legislatures, and non-voting members in the U.S. House of Representatives. Local officials make budgetary decisions about borrowing and therefore the level of debt held by the public in each territory. These territories, like U.S. states in some cases, borrow through financial markets for long-term investments, such as infrastructure projects, or when their budgets are in deficit. The territories, like other borrowers, pay interest on their debt. Both the amounts borrowed and the interest rates determine the amount of interest spending. If unchecked, interest spending can absorb resources that could be used instead to provide government services. In extreme situations, borrowers might be unable to borrow at favorable rates if the market loses confidence in their ability to repay the debt.

Puerto Rico, in particular, has amassed large amounts of debt. In February 2014, Puerto Rico's general obligation bonds were downgraded to speculative—noninvestment grade—by two ratings agencies, Fitch and Standard and Poor's, and to the lowest rating of investment grade by Moody's. Since August 2015, Puerto Rico has defaulted on up to \$1.5 billion in debt payments. In response to the crisis in Puerto Rico, Congress passed and the President signed the Puerto Rico Oversight,

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Management, and Economic Stability Act (PROMESA) in June 2016.<sup>1</sup> PROMESA established a Financial Management and Oversight Board (Board) with broad powers of budgetary and financial control over Puerto Rico. PROMESA also requires us to study fiscal issues in the territories and periodically report on the public debt of each U.S. territory.<sup>2</sup>

For Puerto Rico, American Samoa, CNMI, Guam, and USVI, this report describes (1) trends in public debt and its composition between fiscal years 2005 and 2015, (2) trends in revenue and its composition between fiscal years 2005 and 2015, (3) the major reported drivers of the territory's public debt, and (4) what is known about the ability of the territory to repay public debt.

This report is organized by territory. Because of the wide variation amongst the territories, including differences in their sizes, populations, locations, and economies, it is important to consider each territory as a distinct entity.

To describe trends in each territory's public debt, revenue, and composition, we reviewed the audited financial statements included within each territory's single audit reporting package,<sup>3</sup> hereinafter referred to as

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<sup>1</sup>Pub. L. No. 114-187, 130 Stat. 550 (June 30, 2016).

<sup>2</sup>PROMESA also requires us to review conditions and actions that contributed to Puerto Rico's levels of debt and how the federal government could prevent Puerto Rico or other territories from accumulating debt in the future. We will report the results of that review in a separate report later this year.

<sup>3</sup>The Single Audit Act, as implemented by the Office of Management and Budget (OMB) Circular No. A-133, requires nonfederal entities that expend above a dollar threshold in federal awards in a fiscal year to have a single audit. For the years whose audited financial statements we reviewed, the applicable threshold was \$500,000 or more. Beginning in fiscal year 2015, the threshold was raised to \$750,000. Federal awards include grants, loans, loan guarantees, property, cooperative agreements, interest subsidies, insurance, food commodities, direct appropriations, other assistance, and federal cost-reimbursement contracts. Single audits are audits of the recipient organization—the government in the case of the territories—that focus on the recipient's internal controls and its compliance with laws and regulations governing federal awards. As nonfederal entities expending more than \$500,000 a year in federal awards, the territories are required to submit single audit reports. Recipient organizations are required by the act to submit their single audits reports to the Federal Audit Clearinghouse (FAC). The single audit reporting package sent to the FAC includes (1) the auditor's reports; (2) the entity's audited financial statements and related notes; (3) the schedule of expenditures of federal awards, related notes, and the auditor's report on the schedule; (4) a schedule of findings and questioned costs; (5) reports on internal controls over financial reporting, and compliance with laws and regulations; and (6) a summary schedule of prior audit findings.

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the single audit reports, fiscal years 2005 through 2015<sup>4</sup> and analyzed data on public debt—specifically, bonds, loans, and notes for both the primary government and component units<sup>5</sup>—for each of those years. In addition, we obtained and reviewed data on each of the territories’ revenue from the same single audit reports for each fiscal year for both the primary governments and component units.<sup>6</sup> Our analysis primarily focused on trends in general revenues<sup>7</sup> because the territories’ public debt is either explicitly or implicitly backed by general revenues. We also included total revenue—general revenues and program revenues<sup>8</sup> combined—in our analysis because it includes revenue generated by the territories’ component units and could be used to service debt payments.

For each territory, we obtained and reviewed the independent auditor’s report corresponding to each single audit and noted the type of opinion that was expressed on the financial statements and accompanying note

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<sup>4</sup>Puerto Rico provided consolidated audited financial statements instead of single audit reports and their consolidated financial statement for 2015 was not available as of July 2017. Territory officials anticipate that it will be released by September 2017.

<sup>5</sup>The primary government is generally comprised of governmental activities (generally financed with taxes and intergovernmental aid) and business-type activities (generally financed with charges for goods and services). Component units are legally separate entities for which a government is financially accountable. For the purposes of this report, references to total government activity and balances indicate both the primary government and component units.

<sup>6</sup>Since the period covered in this report is fiscal years 2005 through 2015, it does not include any costs or other impacts of the 2017 hurricanes.

<sup>7</sup>All tax revenues, including tax revenues that are dedicated to particular purposes, are reported in general revenues. Tax revenues represent the largest component of general revenues and include both derived tax revenues (resulting from assessments imposed on exchange transactions, such as income taxes and sales taxes) and imposed non-exchange revenues (resulting from assessments imposed on non-exchange transactions, such as property taxes and fines). General revenues also include unrestricted aid from other governments and investment earnings.

<sup>8</sup>Program revenues are directly linked to functions or programs and include charges for services, as well as grants and contributions for specific functions and programs. While program revenues are generated by the associated functions or programs, such revenues are not always restricted to use in those functions or programs.

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disclosures.<sup>9</sup> With the exception of Puerto Rico each of the territories received modified opinions by auditors on one or more of the single audit reports included in our analysis. We reviewed each of these opinions and determined that despite the modified opinions the data we obtained from each of the single audit reports was reliable for the purpose of describing trends in debt and revenue and their composition for the fiscal years included in our analysis.

To determine the major reported drivers of public debt and what is known about the territories' ability to repay, we interviewed officials from the territories' governments, including officials from the Governors' offices, departments of finance or treasury, and the agency responsible for issuing and marketing bonded debt. In addition, we interviewed representatives of the three rating agencies—Fitch, Moody's and Standard and Poor's—that provide credit ratings for the territories' securities and an investment bank involved with underwriting the territories' bonds. We also interviewed subject matter experts and officials at the Department of the Interior's Office of Insular Affairs (OIA), which provides grant aid and technical assistance and support to the territories.<sup>10</sup> In addition, we obtained and reviewed relevant documentation, reports, and analyses from the territorial governments and ratings agencies. We also obtained and reviewed information on territorial bond issuances from 2005 through 2015 from the Electronic Municipal Market Access (EMMA) database of the Municipal Securities Rulemaking Board, the primary regulator of the municipal securities market.

In addition, to determine what is known about the territories' ability to repay public debt we analyzed common factors—identified through prior work, documents, and interviews with the three rating agencies—that indicate territories' potential vulnerability to debt crises. These factors included 1) the extent to which territories consistently issued debt to fund

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<sup>9</sup>Auditors express unmodified opinions when the auditors conclude that the financial statements are presented fairly, in all material respects, in accordance with the applicable financial reporting framework. Auditors express modified opinions when (1) the auditors conclude that, based on the audit evidence obtained, the financial statements as a whole are materially misstated or (2) the auditors are unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement. A modified opinion can be expressed as a qualified opinion, an adverse opinion, or a disclaimer of opinion.

<sup>10</sup>OIA does not exercise any responsibilities in relation to Puerto Rico.

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general government operations, 2) the extent to which territories' economies were vulnerable to shocks due to a heavy dependence on a single or limited industry, and 3) the extent to which territories faced large fiscal risks such as pension liabilities.

We conducted this performance audit from September 2016 to October 2017 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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## Background

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### U.S. Territories

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**Figure 1: Map of the U.S. Territories**



Source: GAO Map resources. | GAO-18-160

The territories of Puerto Rico and USVI are located southeast of Florida in the Caribbean Sea; American Samoa, CNMI, and Guam are located in the Pacific Ocean some 4,100 to 6,000 miles from the U.S. mainland. (See figure 1.) While the United States exercises sovereignty over the territories, each territory administers its local government functions through popularly elected governors and legislatures. American Samoa, CNMI, and Puerto Rico are self-governed under territorial constitutions; Guam and USVI have not adopted local constitutions and remain governed by Organic Acts enacted by Congress and signed by the

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President.<sup>11</sup> Because the five jurisdictions are unincorporated territories, their residents—although they have many of the rights of citizens of the 50 states—cannot vote in national elections and do not have voting representation in the final approval of legislation by the full Congress.<sup>12</sup>

Puerto Rico, with about 3.5 million residents as of 2015, is the largest U.S. territory. Puerto Rico consists of a main island and several smaller ones—a total of 3,425 square miles. Puerto Rico's economy entered a recession in the fourth quarter of 2006 and has continued to contract since then. According to the Bureau of Labor Statistics (BLS), Puerto Rico had an unemployment rate of 12 percent in August 2015. Congress passed PROMESA in June 2016. PROMESA temporarily prevented creditors from suing Puerto Rico over missed debt payments. PROMESA established a Financial Management and Oversight Board (Board) with broad powers of budgetary and financial control over Puerto Rico. In addition, it created procedures for adjusting debts accumulated by the Puerto Rico government and its component units. On May 3, 2017, after the termination of the original stay preventing creditors from suing the territory, the Board filed a petition under Title III of PROMESA beginning a broad-based debt restructuring process.

American Samoa, with a population estimated at 57,000 in 2015, lies about 2,600 miles southwest of Hawaii and consists of seven islands covering a land area of 76 square miles. The main island of Tutuila has little level land and is mostly rugged. Agricultural production on the island is limited by the scarcity of arable land, and tourism is impaired by the island's remote location and lack of tourist-rated facilities. Most of American Samoa's economic activity—primarily tuna canning—and government operations take place on Tutuila in the Pago Pago harbor area.

CNMI, with a population estimated at 52,100 in 2015, is located in the western Pacific Ocean, just north of Guam and 5,500 miles from the U.S. mainland. The territory is comprised of 14 islands with a total land area of 183 square miles; most of its population resides on the island of Saipan,

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<sup>11</sup>Organic acts are federal laws that serve as the constitution or basic charter of the territory, thereby conferring the powers of government upon a territory. The organic acts usually include a bill of rights and provide for the establishment of the territories' tripartite government.

<sup>12</sup>An unincorporated territory is a U.S. territory to which Congress has determined that only selected parts of the U.S. Constitution apply.



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with additional residents on the islands of Rota and Tinian. Historically, CNMI's economy has depended on garment manufacturing and tourism. After a decade of decline, by 2009 all of the garment factories had closed. The tourism industry declined from 2005 to 2011, but has rebounded since 2012.

Guam, with a population estimated at 162,000 in 2015, is located about 50 miles south of the southernmost island of CNMI and has a total land area of 212 square miles. It has long been a strategic location for the U.S. military. Guam's economy depends largely on U.S. military spending and tourism. As of 2014, the Department of Defense (DOD) controlled about 27 percent of the island. Most of the military members and dependents are attached to one of the two major military installations on the island: U.S. Naval Base Guam, located on the southwestern side of the island at Apra Harbor, or Andersen Air Force Base in the north.

USVI, with a population estimated at 104,000 in 2015, is composed of three main islands—St. Croix, St. John, and St. Thomas—and many other surrounding islands, comprising 134 square miles. Most of the territory's population resides in St. Thomas and St. Croix. Tourism is the primary industry in USVI followed by manufacturing, including rum distilling. In 2012, the Hovensa oil refinery on St. Croix, a joint venture between Hess Corporation and a Venezuelan state-owned oil company, shut down. The refinery was the largest private employer on the island.

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## Public Debt and Revenue

Territorial governments issue debt securities and receive loans for a variety of purposes, including to finance long-term investments, such as infrastructure projects, and to fund government operating costs. For the purposes of this report, total public debt outstanding refers to the sum of bonds and other debt held by and payable to the public, as reported in the territories' single audit reports. Bonds payable are marketable bonded debt securities issued by the territories' primary governments or their component units and held by investors outside those governments. The primary government is generally comprised of governmental activities (generally financed with taxes and intergovernmental aid) and business-type activities (generally financed with charges for goods and services). Component units are legally separate entities for which a government is financially accountable. For the purposes of this report, any reference to total government activity and balances includes both the primary government and component units. Other debt payable may include shorter term marketable notes and bills issued by territorial governments and held by investors outside those governments, non-marketable

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intragovernmental notes, notes held by local banks, federal loans, intragovernmental loans, and loans issued by local banks. Pension liabilities and other post-employment benefits (OPEB)<sup>13</sup> are not included in our definition of total public debt.

Marketable debt securities, primarily bonds with long-term maturities, are the main vehicle by which the territories access capital markets. Municipal bonds issued by all five territories have traditionally been attractive to investors because they are triple tax exempt; interest from the bonds is generally not subject to federal, state, and local income taxes regardless of an investor's state of residence. There are several different types of marketable debt securities:

- General obligation bonds are bonds issued by territorial governments that are payable from the general funds of the issuer, although the precise source and priority of payment for general obligation bonds may vary considerably from issuer to issuer depending on applicable law. Most general obligation bonds are said to entail the full faith and credit (and in many cases the taxing power) of the issuer, depending on applicable law. In USVI, unlike in the other four territories in which general obligations bonds are backed by the full faith and credit of the government, debt issued by the primary government is either backed by 1) both a general obligation of the government and revenue from USVI's gross receipts tax, or 2) revenue from the federal excise tax on rum rebated to the territory.
- Limited obligation bonds are bonds payable from specific taxes that are limited by law in rate or amount, while revenue bonds are payable from specific sources of revenue.
- Marketable notes differ from bonds in that they are short-term obligations of an issuer to repay a specified principal amount on a certain date, together with interest at a stated rate, usually payable from a defined source of anticipated revenues. Notes usually mature in 1 year or less, although notes of longer maturities are also issued.

Bonds and notes may be issued by both the territories' primary governments and by their component units. Examples of the territories' component units are USVI's Water and Power Authority, Guam's Airport

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<sup>13</sup>OPEB are benefits other than pensions that governments provide to their retired employees. These benefits primarily involve health care benefits, but also may include life insurance, disability, and legal and other services.

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Authority, CNMI's Ports Authority, and Puerto Rico's Electric Power Authority.

Unlike the states, territories are prohibited from authorizing their component units to seek debt restructuring under Chapter 9 of the federal bankruptcy code, which can be used to extend the timeline for debt repayment, refinance debt, or reduce the principal or interest on existing debt.<sup>14</sup>

U.S. law restricts the territories' authority to impose certain territorial taxes. Three territories—Guam, CNMI, and USVI—are required by U.S. law to have a mirror tax code.<sup>15</sup> In general this means that these territories must use the U.S. Internal Revenue Code (IRC) as their territorial income tax law. In contrast, American Samoa and Puerto Rico, which are not bound by a mirror tax code, have established and promulgated their own income tax regulations. Although Guam and CNMI are mirror-code jurisdictions, they are authorized under the Tax Reform Act of 1986 to delink from the IRC if certain conditions are met.<sup>16</sup>

Revenues are amounts that result from governments' exercise of their sovereign power to tax or otherwise compel payment. Revenues also include income generated by the territories' component units. While our analysis primarily focuses on trends in general revenues, we also include total revenue—general revenues and program revenues combined—in our analysis. In addition to general revenue levels, another measure of fiscal health is the net position for primary government activities, which represents the difference between the primary government's assets (including the deferred outflows of resources) and the primary government's liabilities (including the deferred inflows of resources). In other words, the net position for primary government activities reflects what the primary government would have left after satisfying its liabilities. A negative net position means that the primary government has more liabilities than assets. A decline in net position may indicate a deteriorating financial position. While our analysis primarily focuses on trends in the net position for the primary government, we also include certain information on trends in the total net position—primary

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<sup>14</sup>11 U.S.C. §§ 101(40); 109(c).

<sup>15</sup>48 U.S.C. §§ 1397 (USVI); 1421i (Guam); 1801 note (CNMI).

<sup>16</sup>Pub. L. No. 99-514, §1271, 100 Stat. 2085, 2591–2592 (Oct. 22, 1986)

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government net position and component unit net position combined— for the government.

Fiscal risks refer to responsibilities, programs, and activities that may legally commit or create the expectation for future government spending. Fiscal risks may be explicit in that the government is legally required to fund the commitment, or implicit in that an exposure arises not from a legal commitment, but from current policy, past practices, or other factors that may create the expectation for future spending. Civilian pension benefits are typically an example of an explicit fiscal risk because the government has a legal commitment to pay pension benefits earned by current government employees who will receive benefits in the future and to pay retirees who currently receive benefits.

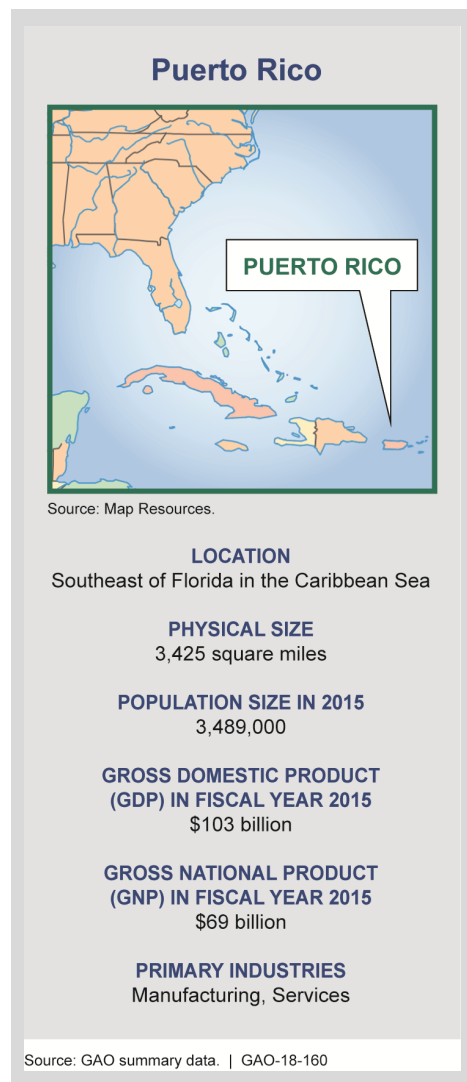
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## Puerto Rico

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### Puerto Rico's Total Public Debt Increased by 73 Percent and It Grew from 47 to 66 Percent of GDP between Fiscal Years 2005 and 2014

#### Total Public Debt Outstanding



Puerto Rico's total public debt outstanding increased continuously between fiscal years 2005 and 2014.<sup>17</sup> (See figure 2.) Total public debt grew from \$39.2 billion in fiscal year 2005 to \$67.8 billion at the end of fiscal year 2014<sup>18</sup>—an average rate of 6.3 percent per year.<sup>19</sup> Bonded debt outstanding<sup>20</sup>—including mainly general obligation and revenue bonds—represented the majority of total public debt outstanding for all years. Bonded debt outstanding averaged 86 percent of total public debt between fiscal years 2005 and 2014, increasing from a total of \$35 billion in fiscal year 2005 to \$58.5 billion in fiscal year 2014. Puerto Rico's Consolidated Audited Financial Report for fiscal year 2015 was not available as of June 2017. However, in the March 13, 2017, fiscal plan

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<sup>17</sup>Since the period covered in this report ends with fiscal year 2015 or 2014 (for Puerto Rico), it does not include any cost or impacts from the 2017 hurricanes.

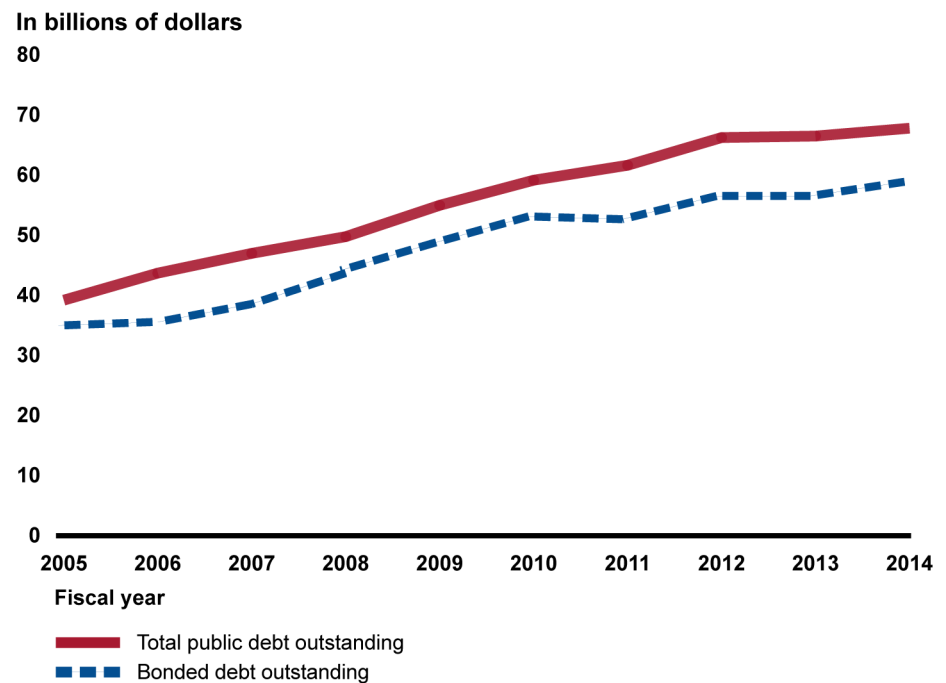
<sup>18</sup>In fiscal year 2014, 41 percent of Puerto Rico's total public debt outstanding was issued by component units.

<sup>19</sup>Our total public debt calculation differs from some other publicly available total debt calculations issued in recent years. For example, we calculated that Puerto Rico had \$67.8 billion in debt as of June 30, 2014, which differs from the \$71.9 billion in public sector debt reflected in the Series A General Obligation Bond Prospectus for approximately the same period. According to Puerto Rico government officials, the \$71.9 billion includes some debt that is not reported in the government-wide financial statements, the statements from which we obtained public debt information, such as \$3.1 billion in pension funding bonds issued by Puerto Rico's Employees' Retirement System. Other smaller differences in the calculations also exist, according to the Puerto Rico government officials, including adjustments made in the bond prospectus calculation to account for the Government Development Bank of Puerto Rico's role as both a lender to the government and a debt issuer.

<sup>20</sup>The total amount of bonded debt outstanding is the amount that remains unpaid by a territory as of a certain date.

released by the Government of Puerto Rico, total public debt outstanding was listed as \$74.3 billion as of February 2017.

**Figure 2: Puerto Rico's Bonded Debt Outstanding as a Component of Total Public Debt Outstanding, Fiscal Years 2005-2014**



Source: GAO analysis of Puerto Rico single audit reports for fiscal years 2005-2014. | GAO-18-160

Note: Public debt outstanding includes debt issued by the primary government and component units as enumerated in the single audit reports.

As of fiscal year 2014, the primary government's bonded debt outstanding was mainly comprised of revenue bonds. These accounted for \$24.3 billion of the \$37.9 billion in total bonded debt. In contrast, between fiscal years 2005 and 2008, general obligation bonds represented the majority of the primary government's bonded debt. In fiscal year 2009, the amount of revenue bonds outstanding tripled. The risks of general obligation bonds and revenue bonds are different. A revenue bond is secured by a specific revenue stream, identified in the bond contract, whereas a general obligation bond is secured by the full taxing power of the government, but also reliant on the full faith and credit of the issuing government. Puerto Rico also issued notes between fiscal years 2005 and 2014.

Puerto Rico’s primary government and the three largest component units—the Puerto Rico Electric Power Authority (PREPA), the Puerto Rico Aqueduct and Sewage Authority (PRASA), and the Puerto Rico Highways and Transportation Authority (PRHTA)—owed the majority of Puerto Rico’s public debt outstanding in fiscal year 2014. (See table 1.) These component units mostly issued debt backed by their own resources, including the revenue generated from their operations. Other component units also held public debt in fiscal year 2014, including the Government Development Bank, State Insurance Fund Corporation and the Puerto Rico Trade and Export Company, among others. The primary government’s share of total public debt outstanding grew relative to debt owed by all of the component units from 44 percent in fiscal year 2005 to 59 percent in fiscal year 2014.

**Table 1: Total Public Debt Outstanding Owed by Government Entities in Puerto Rico as a Percentage of Total Debt, Fiscal Year 2014**

Government Entity	Percent of Total Public Debt
Primary Government	59
PREPA (Puerto Rico Electric Power Authority)	14
PRASA (Puerto Rico Aqueduct and Sewer Authority)	7
PRHTA (Puerto Rico Highways and Transportation Authority)	7
Other component units	12

Source: GAO analysis of Puerto Rico financial statements for fiscal year 2014 | GAO-18-160

Note: Percentages do not add up to 100 percent due to rounding.

**Public Debt as a Share of GDP and GNP**

Puerto Rico’s total public debt outstanding as a percentage of Gross Domestic Product (GDP) grew from 47 percent in fiscal year 2005 to 66 percent in fiscal year 2014, and its ratio of total public debt outstanding to Gross National Product (GNP) grew from 71 percent of GNP in fiscal year 2005 to 99 percent in fiscal year 2014.<sup>21</sup> (See figure 3.) GDP measures the value of goods and services produced inside a country, or for the purpose of this report, a territory. In contrast, GNP measures the value of goods and services produced by its residents. GNP includes production from residents abroad and excludes production by foreign companies in a country. In Puerto Rico, GDP has consistently been greater than GNP, which means that production by foreign companies in Puerto Rico is larger than production by Puerto Rican residents in the territory and

<sup>21</sup>We do not present information on debt as a share of GNP for the other four territories.

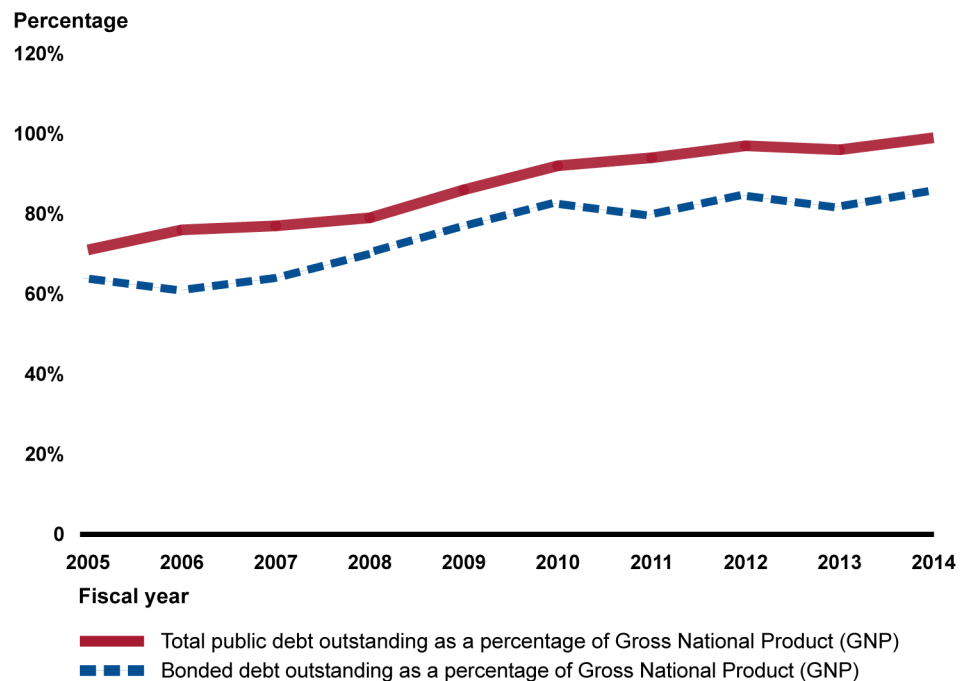
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abroad. For this reason, according to the U.S. Department of the Treasury, GNP is generally a more representative measure of Puerto Rico's economic activity than GDP.

A July 2014 report by the Federal Reserve Bank of New York stated that debt to GNP ratios above just 60 percent can inhibit economic growth because they generally lead to higher financing costs and limit access to other sources of financing.<sup>22</sup> Puerto Rico's share of total public debt outstanding to GNP has remained above 90 percent since 2010.

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**Figure 3: Puerto Rico's Public Debt Outstanding as a Share of Gross National Product (GNP), Fiscal Years 2005-2014**



Source: GAO analysis of Puerto Rico data. | GAO-18-160

Note: Public debt outstanding includes debt issued by the primary government and component units as enumerated in the single audit reports.

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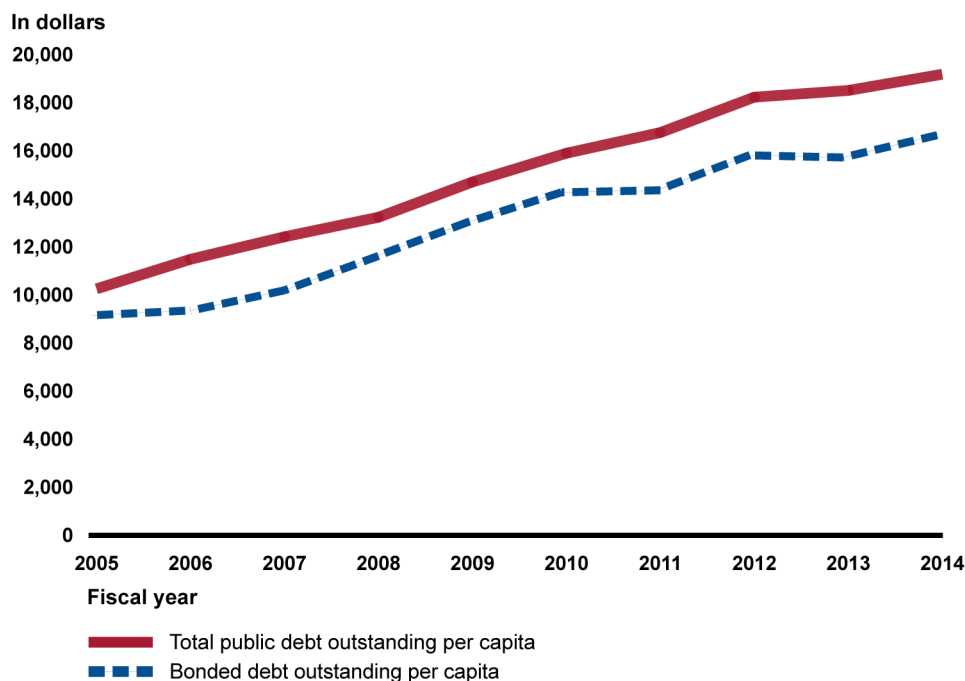
<sup>22</sup>Federal Reserve Bank of New York, *Update on the Competitiveness of Puerto Rico's Economy* (New York: July 31, 2014).



## Public Debt Per Capita

Puerto Rico's total public debt outstanding per capita has almost doubled since fiscal year 2005, rising from \$10,000 per person in fiscal year 2005 to \$19,000 per person in fiscal year 2014. (See figure 4.)

**Figure 4: Puerto Rico's Total Public Debt Outstanding Per Capita, Fiscal Years 2005-2014**



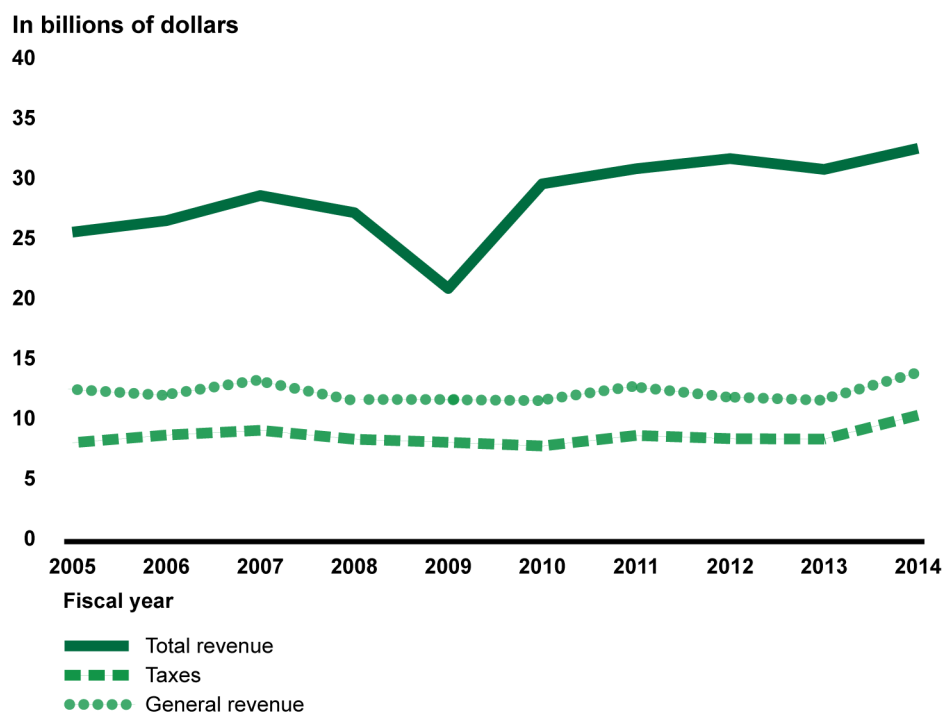
Source: GAO analysis of Puerto Rico data. | GAO-18-160

Note: Public debt outstanding includes debt issued by the primary government and component units as enumerated in the single audit reports.

## Despite Some Growth in General Revenue, Puerto Rico's Net Position Declined between Fiscal Years 2005 and 2014

Puerto Rico's general revenue fluctuated between fiscal years 2005 and 2014, with lows around \$11.6 billion between fiscal years 2008 and 2010 and again in 2013. Puerto Rico's general revenue in fiscal year 2014 was \$13.8 billion, of which 75 percent or \$10.3 billion was tax revenue. Most of the tax revenue for the same year was reported as income taxes (52 percent of the total or \$5.4 billion) and excise taxes (33 percent of the total or \$3.4 billion.) Revenue in fiscal year 2014 increased by over \$2 billion from the prior year. The majority of this growth was due to increases in income and excise taxes. Puerto Rico's total revenue (i.e. general revenue and program revenue combined) also fluctuated but grew slightly by 3 percent on average, per year, from \$25.5 billion in fiscal year 2005 to \$32.5 billion in fiscal year 2014. (See figure 5.)

**Figure 5: Puerto Rico's Revenue, Fiscal Years 2005-2014**



Source: GAO analysis of Puerto Rico single audit reports for fiscal years 2005-2014. | GAO-18-160

Note: Revenue includes general revenue and program revenue generated by the primary government and component units as enumerated in the single audit reports. Tax revenue is part of general revenue.

Despite the growth in revenue in fiscal year 2014, Puerto Rico's net position for the primary government as of fiscal year end 2014 was a negative \$49.7 billion, declining from a negative \$46.4 billion as of fiscal year end 2013. Moreover, despite the fluctuations in revenue between fiscal years 2005 and 2014, Puerto Rico's net position for the primary government declined year over year from a negative \$15.2 billion as of fiscal year end 2005 to a negative \$49.7 billion as of fiscal year end 2014.<sup>23</sup> Puerto Rico's declining net position for the primary government reflects its deteriorating financial position. Further, the effect of Puerto Rico implementing Governmental Accounting Standards Board (GASB)

<sup>23</sup>The one exception to this trend occurred in fiscal year 2008 when Puerto Rico's net position for the primary government improved modestly from a negative \$17.7 billion as of fiscal year end 2007 to a negative \$17.1 billion as of fiscal year end 2008.

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Statement No. 68, *Accounting and Financial Reporting for Pensions —An Amendment of GASB Statement No. 27*, is not yet known. GASB Statement No. 68 was in effect for fiscal years beginning after June 15, 2014, and established standards for measuring and recognizing liabilities, deferred outflows of resources, and deferred inflows of resources related to pensions. For each of the other territories that implemented GASB Statement No. 68, implementing the statement resulted in the territory recognizing previously unrecognized net pension liabilities and, therefore, a decline in ending net position in the year of recognition.<sup>24</sup>

Puerto Rico's total net position for the primary government and component units combined also declined year over year between fiscal years 2005 and 2014, from a positive \$2.5 billion as of fiscal year end 2005 to a negative \$43.6 billion as of fiscal year end 2014.

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## Experts Identified Several Factors That Have Contributed to Puerto Rico's High Debt Levels

Puerto Rico officials, representatives from ratings agencies that we spoke to, and publically available reports that we reviewed cited various major factors as contributors to Puerto Rico's high debt levels.<sup>25</sup> The factors cited include the following:

- **Public debt financing government operations:** Ratings agency officials told us that Puerto Rico has long used public debt as a means to finance general government operations and indicated that debt has been used for this purpose in Puerto Rico since at least 2000. According to these officials, the sustained use of debt to finance general government operations is unusual when compared to states and was considered a "red flag" in the case of Puerto Rico. As Puerto Rico's debt grew, the government found it increasingly difficult to meet other responsibilities, including paying tax returns, settling accounts payable, and fulfilling pension obligations.<sup>26</sup>

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<sup>24</sup>Each of the territories use U.S. generally accepted accounting principles for government as prescribed by GASB as their financial reporting framework.

<sup>25</sup>As noted previously we will issue a separate report, as required by PROMESA, that will further describe the factors that reportedly led to Puerto Rico's financial condition and levels of debt.

<sup>26</sup>In addition to total public debt described above, Puerto Rico's primary government reported \$14.6 billion in current pension liabilities and other post-employment benefit (OPEB) liabilities of \$270 million. OPEBs are benefits other than pensions that governments provide to their retired employees. These benefits primarily involve health care benefits, but also may include life insurance, disability, and legal and other services.

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- **Triple tax exempt status:** Debt in Puerto Rico was attractive to investors for its triple tax exempt status. Over time, Puerto Rico's primary government accumulated debt from investors without addressing its persistent deficits. According to the February 28, 2017, version of the Puerto Rico government's fiscal plan, Puerto Rico's capacity to issue debt at favorable rates postponed the implementation of fiscal reforms and controls necessary to balance Puerto Rico's budget.
  - **Financial data limitations:** A lack of comprehensive, timely, and accurate financial data from Puerto Rico may have limited the ability of some investors to anticipate or fully understand the economic crisis in the territory. For example, according to the Government of Puerto Rico's February 28, 2017, version of the fiscal plan, audited financial statements for Puerto Rico were only issued on time three times from 2005 to 2014. Audited financial statements are still currently pending for fiscal years 2015 and 2016. In addition, forecasts routinely overestimated revenue.
  - **Recession and outmigration:** Recession and outmigration have resulted in reduced tax revenue. A recession in Puerto Rico began in 2006 and continued through the period we reviewed. Outmigration also accelerated most years since 2005 as Puerto Ricans migrated to the U.S. mainland and elsewhere. According to U.S. Census Bureau estimates, Puerto Rico lost 14 percent of its population, more than 550,000 individuals, between July 2009 and July 2016.
  - **936 tax credit phase out:** The phase out of the section 936 tax credit is often cited by Puerto Rico officials for its negative effect on Puerto Rico's economy. Other experts said the effect was not as significant. In addition, in 2006, we reported that the expiration of the benefit did not ultimately lead to a reduction in income and value added.<sup>27</sup> A substantial share of production in Puerto Rico is carried out by U.S. multinational corporations, in part because of federal corporate income tax benefits, once available to firms located in Puerto Rico. Prior to 1994, certain U.S. corporations could claim the possessions tax credit under section 936 of the Internal Revenue Code (IRC). In general, the credit equaled the full amount of federal tax liability related to an eligible corporation's income from its operations in a possession—including Puerto Rico—effectively making such income

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<sup>27</sup>GAO, *Puerto Rico: Fiscal Relations with the Federal Government and Economic Trends during the Phaseout of the Possessions Tax Credit*, [GAO-06-541](#) (Washington, D.C.: May 19, 2006).

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tax-free. In 1993, caps were placed on the amount of possessions credits that corporations could earn. In 1996, the credit was repealed, although corporations that were existing credit claimants were eligible to claim credits through 2005.<sup>28</sup>

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## Outcomes of Restructuring Process Will Determine Outlook for Repayment of Debt

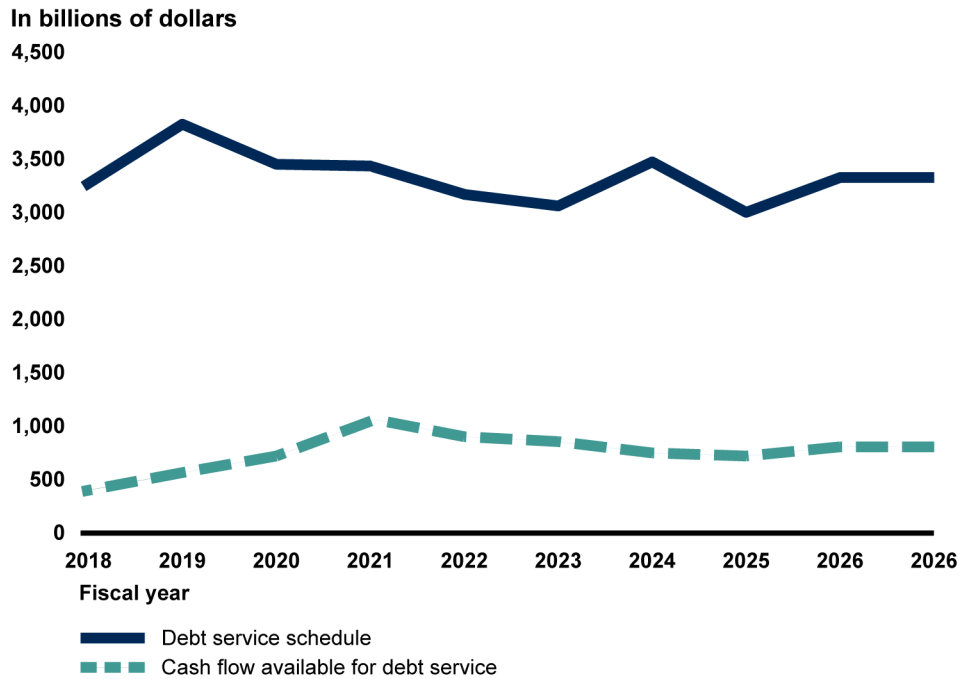
Puerto Rico had missed up to \$1.5 billion in debt service payments as of September 2016. Puerto Rico's government is working with the Financial Management and Oversight Board (Board) to implement plans for long-term financial reform and to adjust debts accrued by both the primary government and public corporations. The Board has the power to approve or certify fiscal plans, budgets, voluntary agreements with bondholders, debt restructuring plans, and critical projects within Puerto Rico. As the first step in a process to adjust debts in Puerto Rico, the Board certified the current Governor's fiscal plan in March 2017, which outlines strategies for financial reform.<sup>29</sup> The fiscal plan includes estimates for how much each year can be allocated for debt payments, which average 23 percent of total debt payments due for the years 2018 through 2026. (See figure 6.)

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<sup>28</sup>The possessions tax credit was criticized on the grounds that the associated revenue cost was high compared to the employment it generated, and because a large share of the benefits of the credit was not reaped by Puerto Rico residents. The Omnibus Budget Reconciliation Act of 1993 placed caps on the amounts of possessions credits that corporations could earn for tax years beginning in 1994 or later. Pub. L. No. 103-66, § 13227, 107 Stat. 312, 489–494 (Aug. 10, 1993). The Small Business Job Protection Act of 1996 repealed the possessions tax credit for taxable years beginning after 1995. Pub. L. No. 104-188, § 1601, 110 Stat. 1755, 1827–1833 (Aug. 20, 1996).

<sup>29</sup>Government of Puerto Rico, *Fiscal Plan for Puerto Rico* (San Juan: Mar. 13, 2017).

**Figure 6: Puerto Rico's Estimated Debt Service vs. Debt Service Due, Fiscal Years 2018–2026**



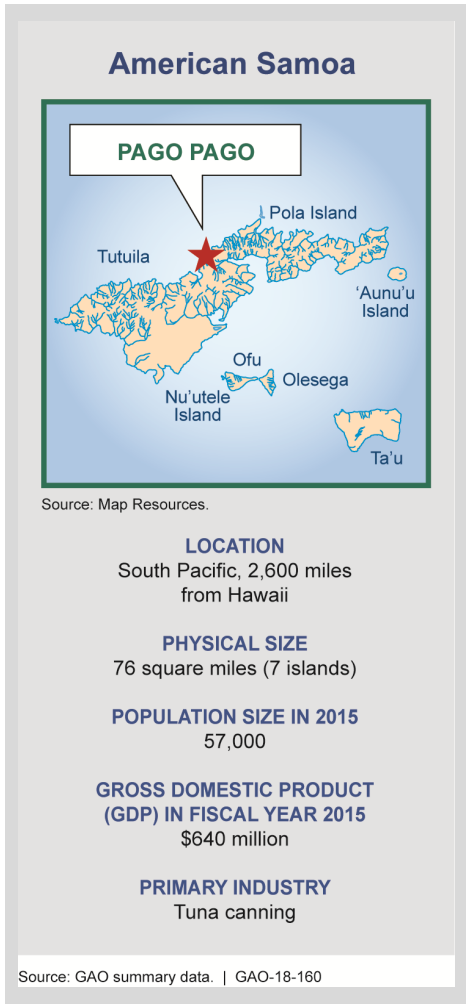
Source: Government of Puerto Rico Fiscal Plan, March 13, 2017. | GAO-18-160

On May 3, 2017, the Board filed an initial petition for restructuring Puerto Rico's debt and pension liabilities. Puerto Rico's ultimate liability for its outstanding debt will be determined based on the outcome of this process in federal court.

# American Samoa

## American Samoa’s Total Public Debt More Than Doubled and It Grew from 5 to 11 Percent of GDP between Fiscal Years 2005 and 2015

### Total Public Debt Outstanding



American Samoa’s total public debt outstanding grew from \$27 million in fiscal year 2005 to \$69.5 million in fiscal year 2015.<sup>30</sup> Until fiscal year 2015, the portion of American Samoa’s total public debt outstanding that was bonded debt outstanding was limited. (See figure 7.) In fiscal year 2007, the territory paid off a general obligation bond that was issued in fiscal year 2000 to refinance prior debt. Between fiscal years 2008 and 2014, American Samoa had no outstanding bonded public debt. In fiscal year 2015, American Samoa’s primary government issued a general obligation bond for about \$55 million, and in January 2016 a second bond was issued for \$23 million. Most of American Samoa’s bonded debt outstanding is scheduled to mature by 2035.

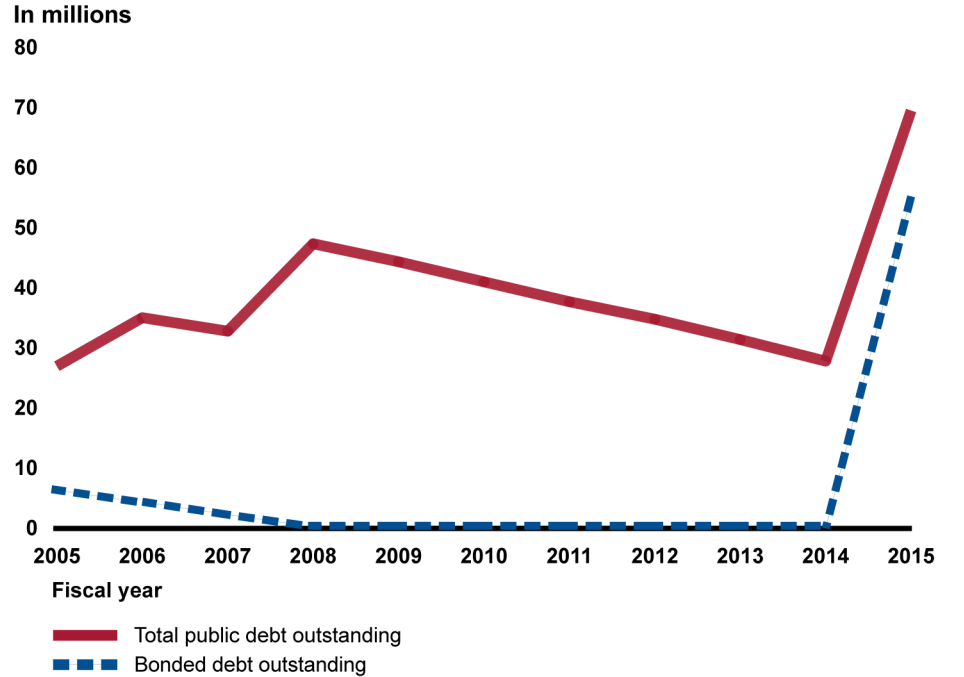
Between fiscal years 2005 and 2015, American Samoa’s loan balance was significantly greater than bonded debt outstanding for all years except fiscal year 2015. American Samoa’s loan balance consists of both loans from the U.S. government and intragovernmental loans, or loans between the territory’s primary government and component units. Between fiscal years 2005 and 2015, this included 1993 and 1994 Federal Emergency Management Agency community disaster loans totaling \$10.2 million and a 1999 Department of the Interior loan in the amount of \$18.6 million.<sup>31</sup> In 2006 and 2007, the primary government also

<sup>30</sup>Territory officials told us two component units, the American Samoa Power Authority and the Lyndon B. Johnson Tropical Medical Center, are authorized to issue debt. However, debt issued by component units is not reflected in American Samoa’s government-wide single audit reports between fiscal years 2005 and 2015.

<sup>31</sup>The Consolidated Appropriations Act, 2000, authorized the Secretary of the Interior to lend American Samoa up to \$18.6 million at a 5.4 percent interest rate in exchange for an irrevocable assignment of the payments due to the territory under the Master Settlement Agreement with certain tobacco companies. Pub. L. No. 106-113, app. C, § 125, 113 Stat. 1501, 1501A-160 to 1501A-164 (Nov. 29, 1999).

entered into two loan agreements with the government retirement fund, in the amounts of \$10 million and \$20 million, in part to finance infrastructure projects.

**Figure 7: American Samoa's Bonded Debt Outstanding as a Component of Total Public Debt Outstanding, Fiscal Years 2005-2015**



Source: GAO analysis of American Samoa single audit reports for fiscal years 2005-2015. | GAO-18-160

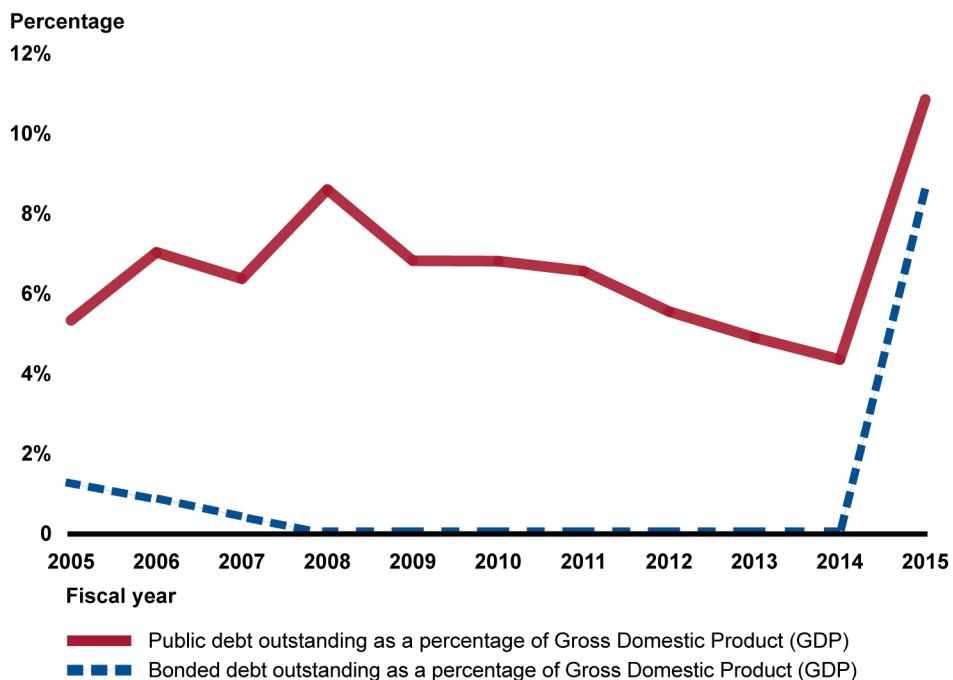
Note: Public debt outstanding includes debt issued by the primary government and component units as enumerated in the single audit reports.



## Public Debt as a Share of GDP

American Samoa's total public debt outstanding has remained small relative to its economy between fiscal years 2005 and 2015. During this period, American Samoa's total public debt outstanding as a percentage of GDP was 5.3 percent in fiscal year 2005, reached a low of 4.4 percent in fiscal year 2014, and grew to 10.9 percent in fiscal year 2015. During this same period, bonded debt outstanding as a share of GDP was 1.3 percent in fiscal year 2005, declined to 0.44 percent in fiscal year 2007 and remained at 0 percent between fiscal years 2008 and 2014. The new bond issuance in fiscal year 2015 increased the share to 8.6 percent. (See figure 8.)

**Figure 8: American Samoa's Public Debt Outstanding as a Share of Gross Domestic Product, Fiscal Years 2005-2015**



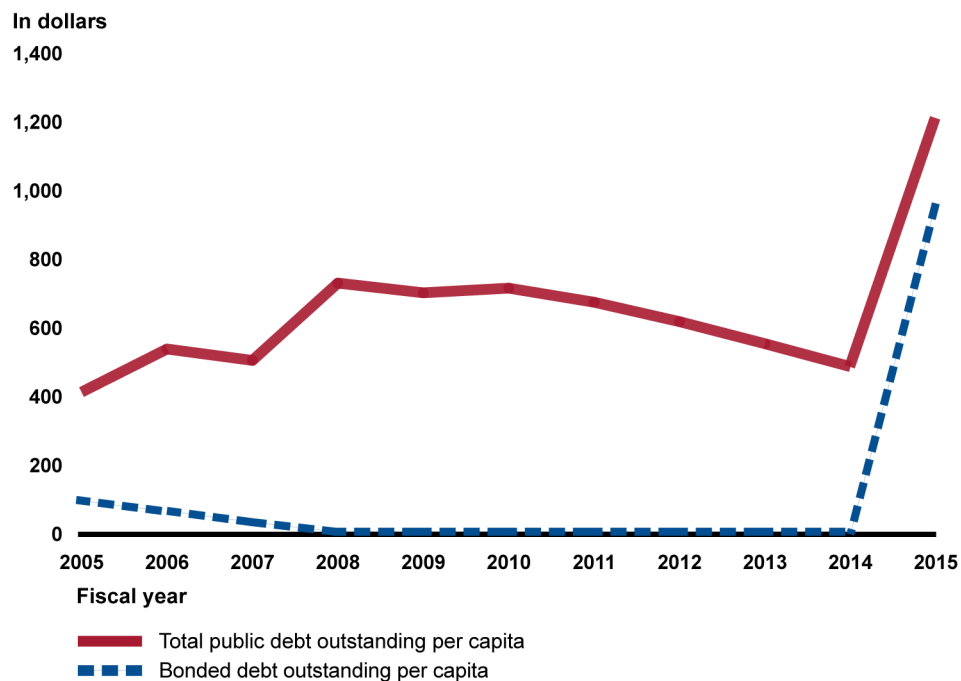
Source: GAO analysis of American Samoa data. | GAO-18-160

Note: Public debt outstanding includes debt issued by the primary government and component units as enumerated in the single audit reports.

## Public Debt Per Capita

Total public debt per capita grew from \$414 per person in fiscal year 2005 to \$1,212.8 in fiscal year 2015. (See figure 9.)

**Figure 9: American Samoa's Public Debt Outstanding Per Capita, Fiscal Years 2005-2015**



Source: GAO analysis of American Samoa data. | GAO-18-160

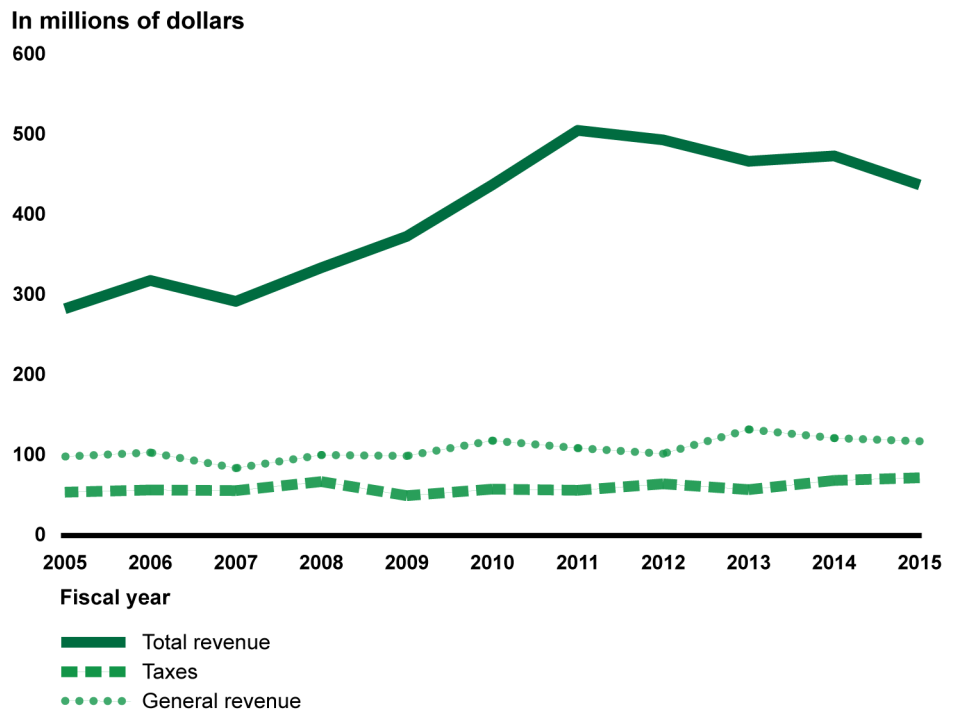
Note: Public debt outstanding includes debt issued by the primary government and component units as enumerated in the single audit reports.

## American Samoa's General Revenue Grew and Net Position Was Positive and Generally Improving between Fiscal Years 2005 and 2015

American Samoa's general revenue fluctuated, but trended upward between fiscal years 2005 and 2015. American Samoa's general revenue of \$116.5 million in fiscal year 2015 represented a 20 percent increase over its revenue of \$97.4 million in fiscal year 2005. Approximately 55 percent of the general revenue earned by American Samoa during this period was comprised of tax revenue, and all of the tax revenue was from income and excise taxes. American Samoa's total revenue (i.e. general revenue and program revenue combined) also fluctuated but trended upward between fiscal years 2005 and 2015. Its total revenue of \$436.4 million in fiscal year 2015 represented a 55 percent increase over its total revenue of \$281.8 million in fiscal year 2005. According to territory officials, growth in revenue during this period can be attributed in part to

revenue generated by stimulus funding the territory received as part of the American Recovery and Reinvestment Act of 2009.<sup>32</sup> (See figure 10.)

**Figure 10: American Samoa's Revenue, Fiscal Years 2005-2015**



Source: GAO analysis of American Samoa single audit reports for fiscal years 2005-2015. | GAO-18-160

Note: Revenue includes general revenue and program revenue generated by the primary government and component units as enumerated in the single audit reports. Taxes are part of general revenue.

Along with the growth in revenue, American Samoa's net position for the primary government was consistently positive and generally improving between fiscal years 2005 and 2014. American Samoa's net position for the primary government generally improved year over year from a positive \$217.7 million as of fiscal year end 2005 to a positive \$291.9 as of fiscal year end 2014; it then declined to a positive \$245.1 million as of fiscal year end 2015. American Samoa's net position for the primary government as of fiscal year end 2014 is shown prior to restatement. In fiscal year 2015, American Samoa implemented GASB Statement No. 68 and adjusted its beginning net position by \$60.1 million, resulting in a

<sup>32</sup>Pub. L. No. 111-5, 123 Stat. 115 (Feb. 17, 2009).

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restated net position as of fiscal year end 2014 of a positive \$240.8 million. The implementation of GASB Statement No. 68 resulted in the territory recognizing previously unrecognized net pension liabilities and, therefore, a decline in ending net position in the year of recognition.

American Samoa's total net position for the primary government and component units combined was also consistently positive and generally improving between fiscal years 2005 and 2015. It increased from \$317.9 million as of fiscal year end 2005 to \$450.2 million as of fiscal year end 2015.

The territory has previously faced financial management challenges, including failures to meet revenue projections and deficiencies in forecasting expenditures. Territory officials said, however, that they are taking a number of steps to improve forecasting. In early 2015, officials convened a task force in Hawaii to develop a plan to improve the management of American Samoa's finances. As part of the effort to improve forecasting, the plan requires the treasury and budget departments to meet on a monthly basis to reconcile actual revenues and expenditures and brief the Governor. If revenues are below projections, the Governor may instruct all government departments to reduce spending by an additional 5-10 percent. In addition, officials told us that the territory is planning to procure a contractor in fiscal year 2017 to help further improve its revenue and spending forecasts.

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### American Samoa's Bonded Debt Was Issued Primarily to Fund Infrastructure Projects

According to territory officials, American Samoa has never issued debt to fund government operating costs and does not intend to do so. Territory officials confirmed that the fiscal year 2015 and 2016 general obligation bonds were issued primarily to fund various infrastructure projects, including relocating airport fuel tanks, constructing an inter-island ferry, and establishing a territorial charter bank.

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## American Samoa Faces Economic Vulnerabilities That May Affect Its Ability to Repay Public Debt

While American Samoa's level of public debt is relatively low compared to other territories, we found that it faces significant economic vulnerabilities that may hamper its ability to repay that debt. According to territory officials and our prior work, American Samoa's economy relies heavily on the tuna processing and canning industry.<sup>33</sup> In December 2016, we reported that canneries employed about 14 percent of American Samoa's workforce in 2014.<sup>34</sup> Moreover, we found that the canneries provided a number of indirect benefits to other industries and the economy in American Samoa. For example, other businesses exist because of the canneries, such as the company that manufactures the cans. Maintenance for the canneries and for the vessels that supply the canneries also has brought business and jobs to the island. Cannery workers spend money at local establishments, such as restaurants and retail stores. Additionally, exported cannery products and delivery of materials to the canneries reduced the shipping cost of bringing other goods to American Samoa. We also reported that the tuna canning industry faces a number of challenges;<sup>35</sup> in addition territory officials expressed concerns about federal policies that may hamper American Samoa's tuna industry, such as scheduled minimum wage increases that increase labor costs for tuna canning in American Samoa relative to other locations, decreased access to fishing grounds in the Pacific due to environmental regulations, and potential erosion of the territory's preferential trade status. In October 2016, one of the two companies with canning operations in American Samoa announced that it would indefinitely suspend its operations in the territory, and the other temporarily suspended operations twice during the same year. Changes

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<sup>33</sup> Qualifying American Samoa corporations have received a tax credit for U.S. corporate income taxes. While tax credits under section 936 of the IRC generally expired for taxable years beginning after December 31, 2005 credits for certain corporations in American Samoa were extended, subject to certain limitations. Corporations that were actively conducting business in American Samoa by 1995 and that elected Section 936 status in the last taxable year before January 1, 2006, could claim a section 30A tax credit for tax years 2006 and beyond. . To claim the credit for tax years beginning after January 1, 2012, corporations must meet additional requirements, including the requirement that corporations have "qualified production activities income." The American Samoa economic development credit has been extended to apply in tax years beginning before January 1, 2017. 26 U.S.C. 30A note.

<sup>34</sup> GAO, *American Samoa: Alternatives for Raising Minimum Wages to Keep Pace with the Cost of Living and Reach the Federal Level*, [GAO-17-83](#) (Washington, D.C.: Dec. 2, 2016).

<sup>35</sup> [GAO-17-83](#).

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in American Samoa's tuna industry have been important determinants of changes in its GDP, and additional disruptions in the industry would reduce revenue and hamper GDP growth, which, if severe enough, could impede the repayment of existing debt.

In part because of such challenges, Moody's Investor Services assigned a noninvestment grade rating to the territory's bonds in early 2016. According to the rating agency, this downgrade reflected concerns associated with the territory's small and volatile economy, low income levels, weak financial position, and financial management challenges. Territory officials told us that the Puerto Rico debt crisis has affected their access to favorable rates in capital markets, and said that they currently do not have plans to issue any more bonded debt.

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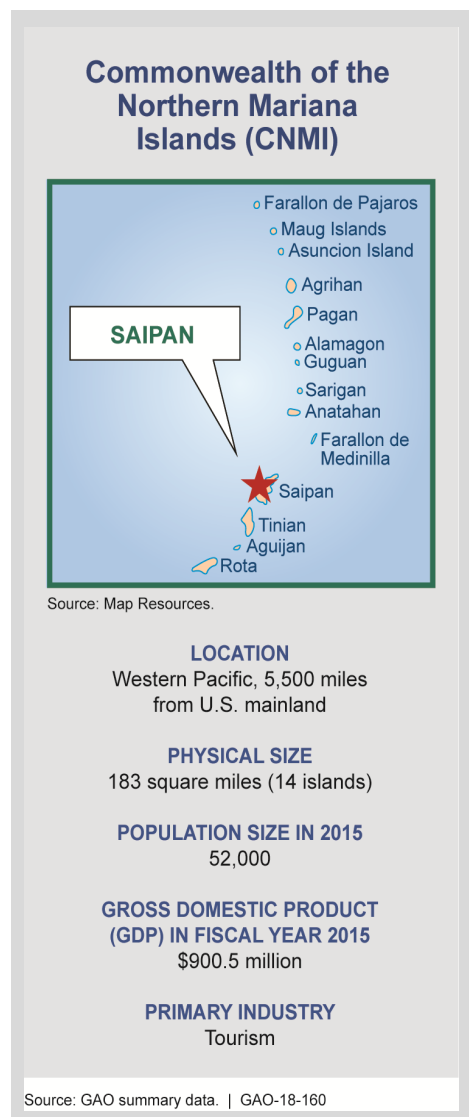
## Commonwealth of the Northern Mariana Islands (CNMI)

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### CNMI's Total Public Debt Declined by \$100 million, Decreasing to 16 Percent of GDP between Fiscal Years 2005 and 2015

#### Total Public Debt Outstanding

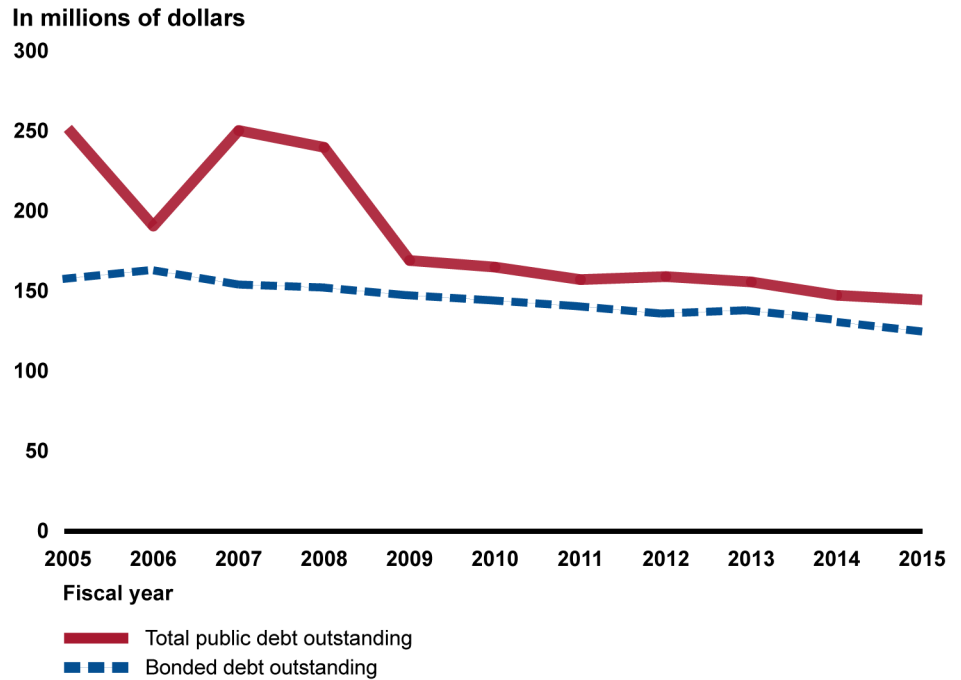
CNMI's total public debt outstanding declined from \$251.7 million in fiscal year 2005 to \$144.7 million in fiscal year 2015.<sup>36</sup> (See figure 11.) During this time, CNMI's primary government issued one general obligation bond in the amount of about \$100.5 million in fiscal year 2007. This general obligation bond refinanced two prior bonds that were issued in fiscal years 2000 and 2003. Most of CNMI's bonded debt outstanding is scheduled to mature in 2030 or later.



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<sup>36</sup>In fiscal year 2015, 38 percent of CNMI's total public debt outstanding was issued by component units.

**Figure 11: The Commonwealth of the Northern Mariana Islands' Bonded Debt Outstanding as a Component of Total Public Debt Outstanding, Fiscal Years 2005-2015**



Source: GAO analysis of CNMI single audit reports for fiscal years 2005-2015. | GAO-18-160

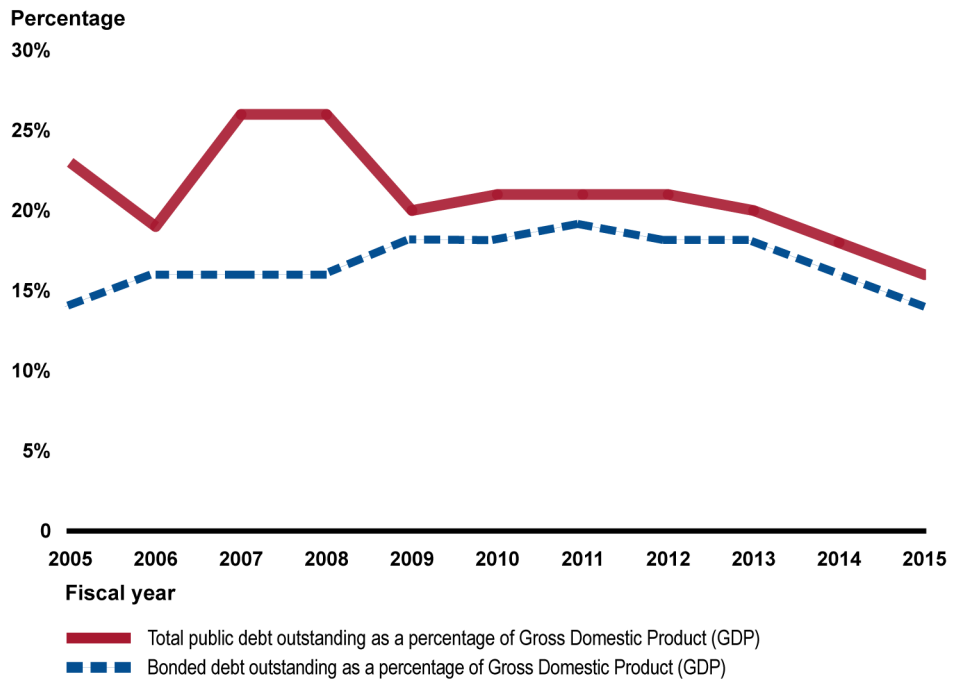
Note: Public debt outstanding includes debt issued by the primary government and component units as enumerated in the single audit reports.

## Public Debt as a Share of GDP

Between fiscal years 2005 and 2015, CNMI's total public debt outstanding as a share of GDP grew from 23 percent in fiscal year 2005 to 26 percent in fiscal year 2007, and then declined to 16 percent in fiscal year 2015. Bonded debt outstanding as a share of GDP was 14 percent in both fiscal years 2005 and 2015, but reached 19 percent in fiscal year 2011. (See figure 12.)



**Figure 12: The Commonwealth of the Northern Mariana Islands' Public Debt Outstanding as a Share of Gross Domestic Product, Fiscal Years 2005-2015**



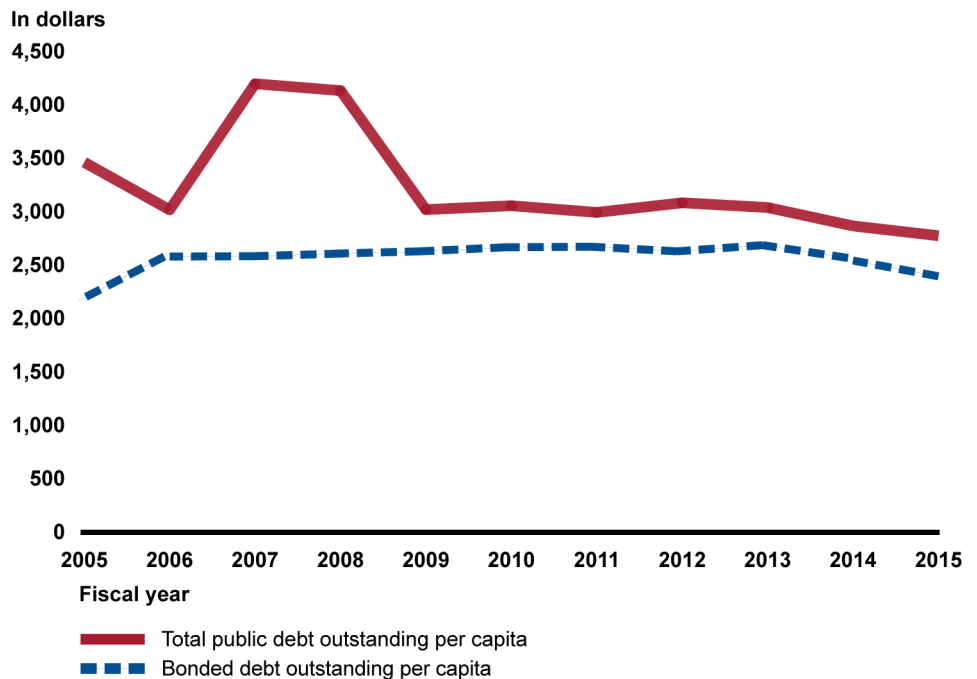
Source: GAO analysis of CNMI data. | GAO-18-160

Note: Public debt outstanding includes debt issued by the primary government and component units as enumerated in the single audit reports.

## Public Debt Per Capita

CNMI's total public debt outstanding per capita declined from about \$4,199 per person in fiscal year 2007 to about \$2,776 per person in fiscal year 2015. (See figure 13.)

**Figure 13: The Commonwealth of the Northern Mariana Islands' Public Debt Outstanding Per Capita, Fiscal Years 2005-2015**



Source: GAO analysis of CNMI data. | GAO-18-160

Note: Public debt outstanding includes debt issued by the primary government and component units as enumerated in the single audit reports.

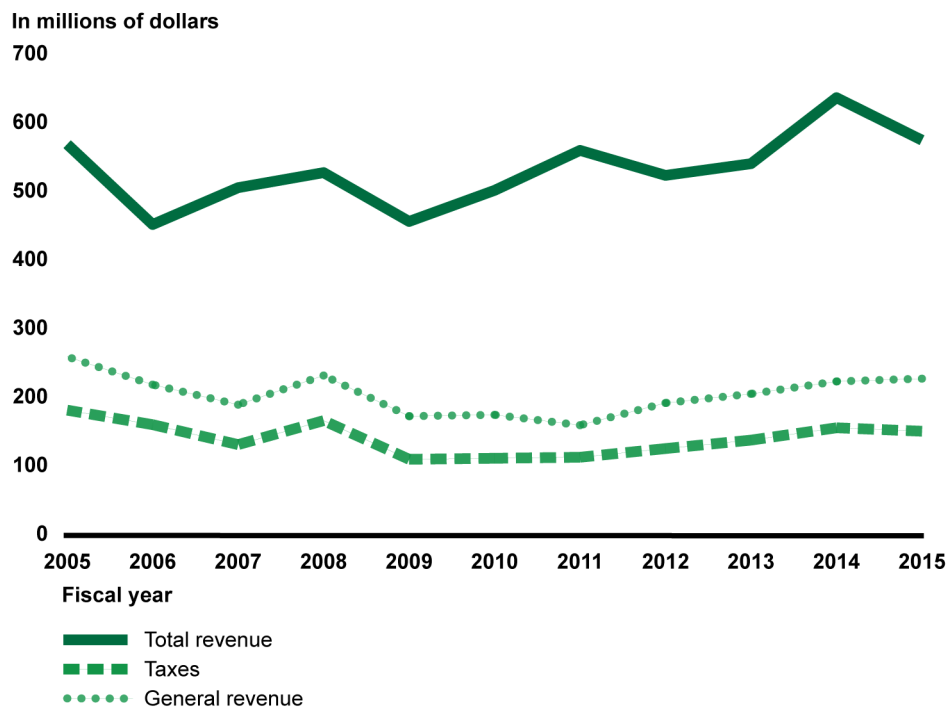
## CNMI's General Revenue Fluctuated and Net Position Was Generally Declining between Fiscal Years 2005 and 2015

CNMI's general revenue fluctuated between fiscal years 2005 and 2015. General revenues declined by about 39 percent between fiscal years 2005 and 2011, largely due to the decline in the territory's garment industry. (See figure 14.) General revenues have steadily increased since fiscal year 2011, primarily as a result of growth in the tourism sector.<sup>37</sup> Data from the Marianas Visitor Authority show that the downward trend in Japanese visitors from 2013 to 2016 was offset by the growth in visitors

<sup>37</sup>Chinese visitors comprised 42 percent of CNMI's tourist population in fiscal year 2016. Chinese visitors are permitted to be temporarily present in CNMI under the U.S. Department of Homeland Security's (DHS) discretionary parole authority, according to DHS officials. DHS exercises parole authority to allow, on a case-by-case basis, eligible nationals of China to enter CNMI temporarily as tourists when there is significant public benefit. According to the CNMI government, if the exercise of the parole authority were discontinued CNMI would experience a significant decrease in its overall tourist arrivals, a shrinkage of its economy, a reduction in employment for U.S. citizens, and a loss in public revenues and the government's ability to provide services to the population.

from China and South Korea.<sup>38</sup> The tourist industry has also been boosted by the introduction of a new casino. In August 2014, the CNMI government entered into a casino license agreement to construct a development project that will include a hotel with a minimum of 2,004 guest rooms and areas for gaming, food, retail, and entertainment, among other things. CNMI's total revenue (i.e. general revenue and program revenue combined) also fluctuated between fiscal years 2005 and 2015. Total revenue reached a high of \$635.7 million in fiscal year 2014 and then declined to \$573.8 million in fiscal year 2015, which represented only a one percent increase over the fiscal year 2005 revenue of \$567.9 million.

**Figure 14: The Commonwealth of the Northern Mariana Islands' Revenue, Fiscal Years 2005-2015**



Source: GAO analysis of CNMI single audit reports for fiscal years 2005-2015. | GAO-18-160

Note: Revenue includes general revenue and program revenue generated by the primary government and component units as enumerated in the single audit reports. Taxes are part of general revenue.

<sup>38</sup>GAO, *Commonwealth of the Northern Mariana Islands: Implementation of Federal Minimum Wage and Immigration Laws*, [GAO-17-437](#) (Washington, D.C.: May 18, 2017).

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While general revenue fluctuated, dipping then rebounding between fiscal years 2005 and 2015, CNMI's net position for the primary government has been negative and generally trending downward. Specifically, CNMI's net position for the primary government declined from a negative \$38.1 million as of fiscal year end 2005 to a negative \$215.4 million as of fiscal year end 2015.<sup>39</sup> CNMI's net position for the primary government has been negative by over \$200 million for each fiscal year since 2010, but it showed a slight improvement between fiscal years 2011 and 2013 and in fiscal year 2015.

CNMI's total net position for the primary government and component units combined fluctuated but generally remained stagnant, increasing slightly from \$281.6 million as of fiscal year end 2005 to \$284.8 million as of fiscal year end 2015.

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**Between Fiscal Years 2005 and 2015, CNMI Issued Public Debt to Refinance Prior Debt and to Fund Infrastructure Projects**

CNMI's Constitution prohibits public indebtedness for operating expenses of the CNMI government or its political subdivisions.<sup>40</sup> In addition, the territory's legislature must approve any bond issuances and the value of any bonds issued cannot exceed 10 percent of the assessed value of real property within CNMI. In fiscal year 2007, the primary government of CNMI issued one general obligation bond to refinance two bonds originally issued in 2000 and 2003. Both the 2000 and 2003 bonds were issued to finance various infrastructure improvement projects. The 2003 issuance was also used for a onetime payment to settle land claims for the appropriation of private lands for public use.

Component units in CNMI also issue debt. In 2007, the Commonwealth Ports Authority, which is responsible for operating, maintaining, and improving all airports and seaports in CNMI, issued a bond for about \$7.2 million. The proceeds of the bond were used in part to pay for improvements to seaport facilities at Saipan Harbor.

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<sup>39</sup>As reported in its fiscal year 2015 single audit report, CNMI received an adverse opinion on its governmental activities because it did not adopt GASB Statement No. 68 in fiscal year 2015. The amount has not been determined by which this departure from U.S. generally accepted accounting principles would have affected net position for its primary government as of fiscal year ends 2014 and 2015.

<sup>40</sup>CNMI Const., art. X, §§ 3, 4.

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## Despite Economic Growth, CNMI Faces Labor Shortages and Fiscal Risks That May Affect Its Ability to Repay Public Debt

While CNMI's economic outlook has improved, with GDP increasing 3 years in a row since 2013,<sup>41</sup> we found that the territory faces growing labor shortages that may affect its ability to repay public debt in the future. In May 2017, we reported that CNMI's economy relies heavily on a foreign workforce and foreign workers comprised a majority of the territory's workforce in 2015. The Consolidated Natural Resources Act of 2008, among other things, established federal control of CNMI immigration beginning in 2009. The act established a transition period with special provisions for foreign visitors, investors, and workers.<sup>42</sup> Specifically, it required the U.S. Department of Homeland Security (DHS) to establish a temporary work permit program<sup>43</sup> for foreign workers and to reduce annually the number of permits issued, reaching zero by the end of the transition period—now set to occur on December 31, 2019.<sup>44</sup> We analyzed the economic effect of removing all permitted<sup>45</sup> foreign workers from CNMI's economy using the most recent GDP information available from calendar year 2015.<sup>46</sup> Depending on assumptions made, with no permitted workers CNMI's GDP in 2015 would have hypothetically declined by 26 to 62 percent.<sup>47</sup> Planned reductions in permitted workers

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<sup>41</sup>According to the Bureau of Economic Analysis CNMI's real GDP grew by 3.5 percent in 2015.

<sup>42</sup>Pub. L. No. 110-229, § 702, 122 Stat. 754, 853-867 (May 8, 2008). The act refers to these individuals as nonimmigrant visitors, investors, or workers, but for the purpose of this report, we refer to them as foreign visitors, investors, or workers.

<sup>43</sup>The temporary work permit program established by DHS is the CNMI-Only Transitional Worker classification (CW-1) permits program. Under this program, foreign workers are able to obtain, through their employers, nonimmigrant CW-1 status that allows them to work in CNMI. Dependents of CW-1 nonimmigrants (spouses and minor children) are eligible for dependent of a CNMI-Only Transitional Worker (CW-2) status, which derives from and depends on the CW-1 worker's status.

<sup>44</sup>48 U.S.C. § 1806(d)(2), as most recently amended by the Consolidated and Further Continuing Appropriations Act, 2015, Pub. L. No. 113-235, § 10, 128 Stat. 2130, 2134 (Dec. 16, 2014).

<sup>45</sup>DHS deemed CW-1 status to be synonymous with "permit" referenced in the legislation. In this report "permitted" refers to CW-1 status.

<sup>46</sup>[GAO-17-437](#).

<sup>47</sup>The relationship between the production capability of an economy and the number of workers is a standard concept in economics. The quantity of labor, or number of workers, is a key factor in determining the quantity of goods and services that an economy can produce. For the U.S. economy, under certain assumptions, a 10 percent reduction in the number of all workers might be expected to cause a 7 percent decline in production, measured as GDP. See [GAO-17-437](#) appendix V for our assumptions.

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could worsen the effect on GDP going forward and hamper the territory's ability to repay existing debt.

CNMI also has significant pension liabilities, but the exact amount of the net pension liability is not included in the territory's most recent single audit report because the government has not complied with accounting standards that require it to do so. In 2013, a U.S. district court approved a settlement agreement with the territory's government pension plan, which applied for bankruptcy in 2012. As part of the settlement, CNMI agreed to make minimum annual payments to the fund to allow members to receive 75 percent of their full benefits. In addition to the settlement plan, CNMI appropriated \$25 million of casino license fees to fund the restoration of the 25 percent reduction of the retirees' and beneficiaries' pensions, among other purposes.<sup>48</sup> CNMI made one payment of \$27 million and another payment of \$19.4 million to the fund in fiscal year 2015. Territory officials told us they are planning to market a \$45 million general obligation bond in 2017 to provide additional financing for the pension fund. They added, however, that they currently have no plans to issue debt for other purposes, such as infrastructure projects, because of uncertainty in the labor market.

In 2012, Moody's Investor Services confirmed CNMI's general obligation bond ratings as non-investment grade, which was downgraded in 2009. According to the rating agency, the 2012 rating was due to losses in the territory's garment industry, consistent operating deficits, and increasing unfunded pension liabilities.

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<sup>48</sup>CNMI Pub. L. 18-56, § 2307(c)(1)(i) (July 11, 2014).

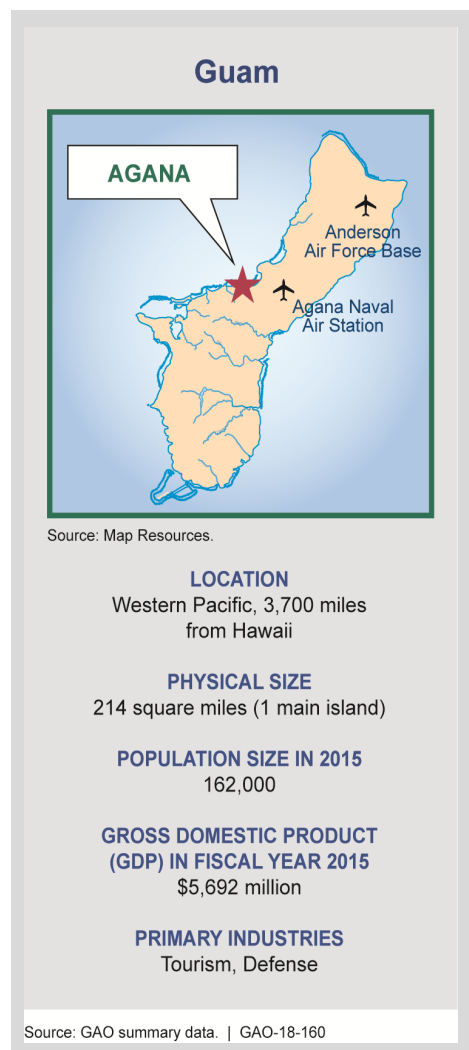
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## Guam

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### Guam's Total Public Debt More Than Doubled and It Grew from 24 to 44 Percent of GDP between Fiscal Years 2005 and 2015

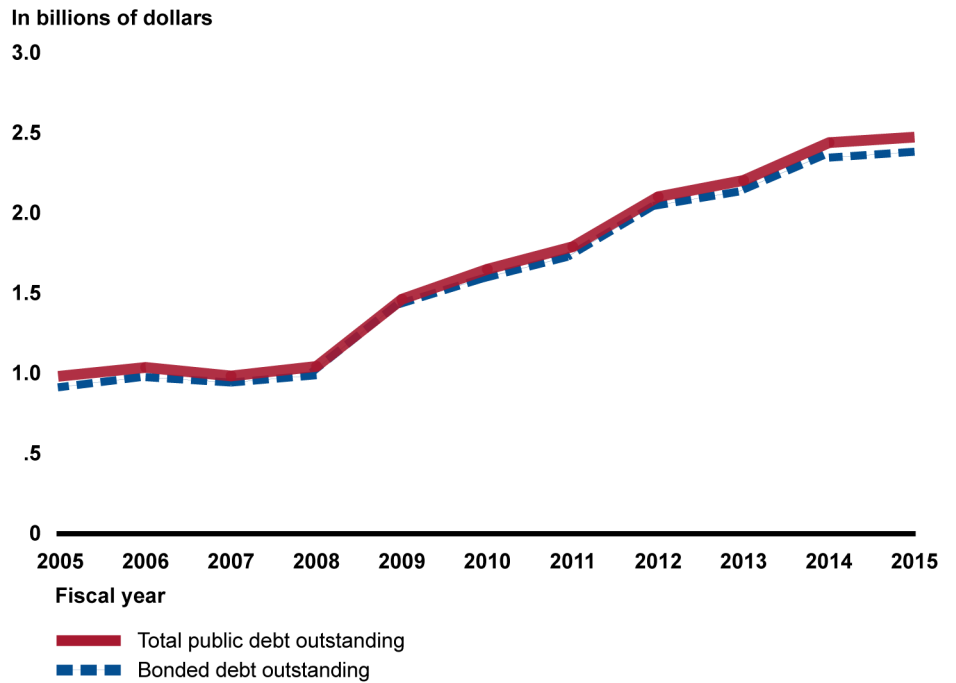
#### Total Public Debt Outstanding



Guam's total public debt outstanding increased from almost \$1 billion in fiscal year 2005 to \$2.5 billion fiscal year 2015, with the majority of the increase occurring between fiscal years 2008 and 2015 when total outstanding public debt grew 13 percent on average per year. (See figure 15.) In fiscal year 2015, 54 percent of Guam's total public debt outstanding was issued by component units. Territory officials told us component unit debt is backed solely by the revenue component units generate and cannot be used to service debt issued by the primary government.

The majority of Guam's total public debt is in the form of bonds. Bonded debt outstanding comprised between 93 and 97 percent of total public debt outstanding from fiscal years 2005 through 2015. Most of Guam's bonded debt outstanding will mature in 2027 or afterwards. The remainder of Guam's public debt outstanding between fiscal years 2005 and 2015 was primarily comprised of notes and loans, including loans from the federal government.

**Figure 15: Guam's Bonded Debt Outstanding as a Component of Total Public Debt Outstanding, Fiscal Years 2005-2015**



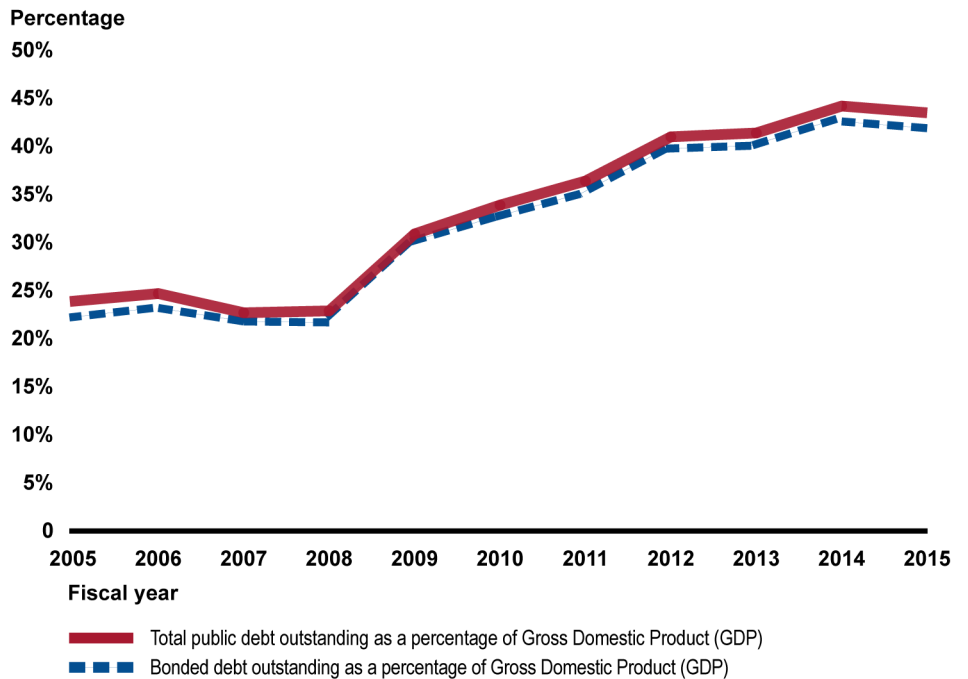
Source: GAO analysis of Guam single audit reports for fiscal years 2005-2015. | GAO-18-160

Note: Public debt outstanding includes debt issued by the primary government and component units as enumerated in the single audit reports.

**Public Debt as a Share of GDP** Between fiscal years 2005 and 2015, Guam's total public debt outstanding as a share of GDP increased from 24 percent to 44 percent, with bonded debt outstanding growing similarly from 22 percent of GDP to 42 percent. (See figure 16.)



**Figure 16: Guam's Public Debt Outstanding as a Share of GDP, Fiscal Years 2005-2015**



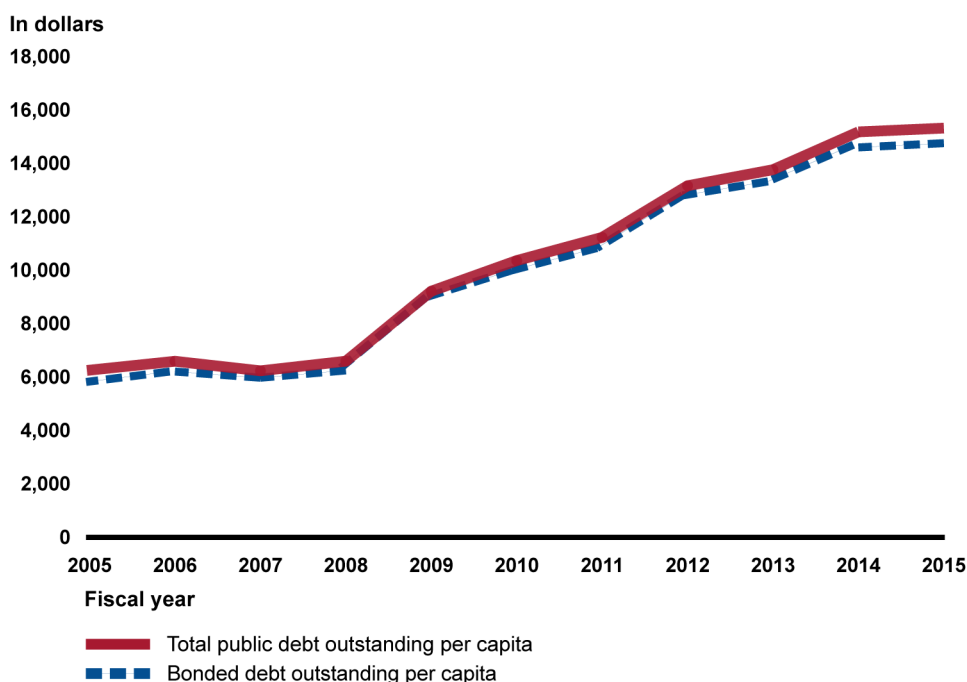
Source: GAO analysis of Guam data. | GAO-18-160

Note: Public debt outstanding includes debt issued by the primary government and component units as enumerated in the single audit reports.

## Public Debt Per Capita

Both total public debt and bonded public debt outstanding per capita more than doubled between fiscal years 2005 and 2015. Total public debt outstanding per capita rose from about \$6,270 per person to \$15,323 per person, while bonded public debt outstanding increased from \$5,810 per person to \$14,759 per person. (See figure 17.)

**Figure 17: Guam's Public Debt Outstanding Per Capita, Fiscal Years 2005-2015**



Source: GAO analysis of Guam data. | GAO-18-160

Note: Public debt outstanding includes debt issued by the primary government and component units as enumerated in the single audit reports.

## Guam's General Revenue Grew and Net Position Fluctuated Significantly between Fiscal Years 2005 and 2015

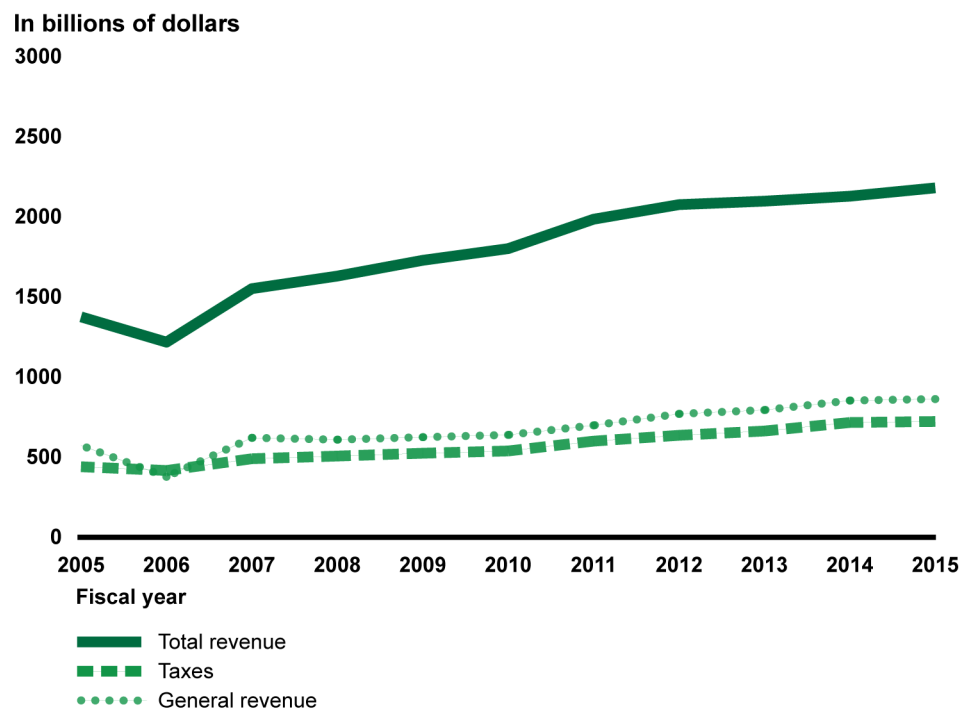
Guam's general revenue grew by 6 percent on average, per year, between fiscal years 2005 and 2015, from \$573.2 million to \$862.7 million. General revenue declined sharply in fiscal year 2006, recovered in fiscal year 2007, and then increased steadily through fiscal year 2015. According to territory officials, this increase in revenue can largely be attributed to economic development, with significant growth in tourism and new construction. A 2015 report to Guam's bondholders noted that there was an increase in visitors to the island each month between 2014 and 2015. The report attributed this increase to several factors, such as the expanded number of airline routes to Guam, the favorable exchange rate for Asian visitors, and the relative improvement of the overall global economy.<sup>49</sup> Guam's total revenue, or general revenue and program

<sup>49</sup>Government of Guam, *Continuing Disclosure Annual Report for the Fiscal Year Ended September 30th, 2015* (Guam: 2015).

revenue combined, also grew by 5 percent on average, per year, between fiscal years 2005 and 2015, from \$1.4 billion to \$2.2 billion. (See figure 18.)

To project revenues, Guam officials use a model comprised of statistical weights that are calculated and assigned to each revenue source, which is derived from historical collections data from the prior fiscal years.

**Figure 18: Guam's Revenue, Fiscal Years 2005-2015**



Source: GAO analysis of Guam single audit reports for fiscal years 2005-2015. | GAO-18-160

Note: Revenue includes general revenue and program revenue generated by the primary government and component units as enumerated in the single audit reports. Taxes are part of general revenue.

While revenue generally grew, Guam's net position for the primary government fluctuated significantly between fiscal years 2005 and 2015. Since fiscal year end 2006, Guam's net position for the primary government has been negative and trending downward. Specifically, Guam's net position for the primary government declined from a positive \$79.8 million as of fiscal year end 2005 to a negative \$194.2 million as of fiscal year end 2012. Net position improved significantly and was positive in fiscal years 2013 and 2014, but then declined from a positive \$174.4

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million as of fiscal year end 2014 to a 10-year low of a negative \$670.9 million as of fiscal year end 2015. Guam's net position for the primary government as of fiscal year end 2014 is shown prior to restatement. In fiscal year 2015, Guam implemented GASB Statement No. 68 and adjusted its beginning net position by \$815.6 million, resulting in a restated net position as of fiscal year end 2014 of a negative \$641.2 million. The implementation of GASB Statement No. 68 resulted in the territory recognizing previously unrecognized net pension liabilities and, therefore, a decline in ending net position in the year of recognition.

Guam's total net position for the primary government and component units combined also fluctuated significantly. Specifically, Guam's total net position increased from a positive \$788.8 million as of fiscal year end 2012 to a 10-year high of positive \$1.2 billion as of fiscal year end 2014. It declined to a 10-year low of positive \$47.3 million as of fiscal year end 2015 due to the implementation of GASB Statement No. 68.

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## Guam Has Used Public Debt to Meet Federal Requirements and Court Orders

According to territory officials, Guam's bonded debt outstanding has primarily been used to comply with federal requirements and court orders.<sup>50</sup> Guam has issued debt in several cases when compelled to meet federal and territorial requirements. For example, since Guam adheres to the mirror tax code, the territory is required to fund the Earned Income Tax Credit (EITC) and is not reimbursed for this by the federal government. In June 2004, the territory agreed to pay \$60 million over 9 years in settlement of unpaid EITC refunds from 1996, and in September 2006, the territory reached a new settlement replacing the 2004 agreement in which it agreed to pay up to \$90 million.

Moreover, in 2006, the Superior Court of Guam held that a territorial statutory provision<sup>51</sup> required the retirement fund for government employees to pay past due annual lump sum Cost of Living (COLA) payments plus interest to eligible retirees and survivors. This resulted in an award of \$123.5 million plus interest to those individuals. In response, Guam issued a general obligation bond in 2007 in the amount of \$151.9 million to finance these past due tax refunds and outstanding COLA settlement payments, as well as to refinance prior debt and help fund infrastructure projects. In 2009, it issued another general obligation bond

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<sup>50</sup>This debt has also been used for infrastructure projects and to refinance prior debt.

<sup>51</sup>4 Guam Code Ann. § 8137.1 (repealed in 1995).

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in the amount of \$271 million for similar purposes. According to a Guam government report, the largest increase in the territory's indebtedness occurred between fiscal year 2008 and fiscal year 2009, and was due in part to issuing bonds to pay for past due tax refunds and unpaid COLA expenses.<sup>52</sup> In Guam's 2017 draft debt management policy, the Governor cited the administration's commitment to ensuring that tax refunds will be paid on time and no later than 6 months after filing.

In addition, in February 2004 the U.S. Environmental Protection Agency (EPA) and the Department of Justice filed a consent decree in the U.S. District Court of Guam.<sup>53</sup> The consent decree set forth the settlement terms agreed to by the federal government and Guam settling a lawsuit alleging Guam violated the Clean Water Act. The consent decree included deadlines for opening a new landfill and adopting a dump closure plan. In response to a 2009 District Court order that Guam comply with the terms of the consent order, the territory chose to issue a \$202.4 million limited obligation bond to fund closing the Ordot dump and constructing a new landfill to meet the terms of the settlement agreement.

Guam also issued revenue bonds between fiscal years 2005 and 2015 to finance infrastructure projects. For example, in 2011 a revenue bond backed by hotel occupancy taxes was issued in the amount of \$90.6 million in part to fund the construction of a museum on the island and other projects to benefit Guam's tourism industry. In addition, in 2013 Guam's Airport Authority issued \$247 million in bonds that were used, in part, to fund airport enhancements.

As established under its Organic Act, Guam has the authority to issue bonds, but Guam's public indebtedness is not authorized or allowed to exceed 10 percent of the aggregate tax valuation of property in the territory; tax valuation of property is currently set at 90 percent of appraised value of property.<sup>54</sup> The limit applies to both general obligation and limited obligation debt. In fiscal year 2007, to increase borrowing capacity to address a \$524 million deficit, the government changed the

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<sup>52</sup>Government of Guam Office of Public Accountability, *Government of Guam Public Debt Report*, Report No. 14-01 (Guam: April 2014).

<sup>53</sup>Consent Decree, United States v. Guam, No. 1:02-cv-00022 (D. Guam 2004).

<sup>54</sup>48 U.S.C. § 1423a.

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percentage of appraised value which constitutes the assessed value.<sup>55</sup> The debt ceiling still limits the amount of public debt Guam can issue to 10 percent of the aggregate tax valuation of property. However, in September 2007, Guam amended its statutory definition of assessed value from 35 percent of appraised property values to 70 percent.<sup>56</sup> In May 2009, the definition tax valuation of property was again amended to 90 percent of appraised property values.<sup>57</sup> This second increase was imposed so Guam could issue bonds to comply with the requirement to close the Ordot dump and open a new landfill. In fiscal year 2012, the government increased borrowing capacity a third time by amending the definition of assessed value to 100 percent of appraised value in order to fund past due tax refunds.<sup>58</sup> In fiscal year 2016, the statutory definition of assessed value was decreased back down to 90 percent of appraised value.<sup>59</sup>

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### Despite Guam's Recent and Expected Economic Growth, Growing Pension Fund Liabilities May Present a Risk

Despite economic growth, we found that Guam faces large fiscal risks related to unfunded pension liabilities and other post-employment benefits (OPEB) that, if unaddressed, may hamper its ability to repay existing debt and increase its need to issue debt. A number of factors may contribute to continued economic growth in Guam. Specifically, according to a government report, visitor arrivals to Guam are projected to continue increasing and higher room rates and occupancy are leading to continued hotel development. Moreover, the Marine Corps has plans to consolidate bases in Okinawa, Japan, and relocate 4,100 Marines to Guam. The Department of Defense (DOD) expects this relocation to Guam to occur between fiscal years 2022 and 2026. Officials from Guam predict that the military buildup will result in significant additional investment in Guam's economy. In July 2016, DOD agreed to give Guam approximately \$55.6 million in grants to fund civilian water and wastewater projects linked to the military buildup; additional investments in the power infrastructure will also be funded by DOD. A 2014 study conducted by the Department of

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<sup>55</sup>The U.S. Supreme Court held that "tax valuation" for purposes of Guam's debt limitation means the value to which the tax rate is applied, or assessed valuation, and not appraised value. *Limtiaco v. Camacho*, 549 U.S. 483 (2007).

<sup>56</sup>Guam Pub. L. 29-19, chap. X, § 5 (Sept. 29, 2007).

<sup>57</sup>Guam Pub. L. 30-7, § 12 (May 11, 2009).

<sup>58</sup>Guam Pub. L. 31-196, § 1(a) (Mar. 28, 2012).

<sup>59</sup>Guam Pub. L. 33-185, chap. XIV, § 2 (Sept. 10, 2016).

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the Navy on the effect of the military buildup on Guam's economy concluded that it would increase civilian labor force demand, increase civilian labor force income, and increase tax revenues.<sup>60</sup>

While it maintained Guam's debt as investment grade as of 2017, the rating agency Standard and Poor's expressed concern about Guam's extremely high debt burden and vulnerability to economic changes in its tourism and military industries. In addition, Guam has large pension and OPEB liabilities that may stress current debt service payment arrangements if anticipated savings from changes to the government pension system are not realized. In fiscal year 2015, pension liabilities were \$1.2 billion and OPEB liabilities were \$2 billion, 22 and 37 percent of GDP, respectively. Territory officials told us that they have taken a variety of steps to address their unfunded pension and OPEB liabilities. In 1995, the government closed the defined benefit plan<sup>61</sup> to new members with all new employees participating in a defined contribution plan,<sup>62</sup> which resulted in a decrease in accrued liabilities. To address insufficient savings by members in the defined contribution plan, the legislature created two new retirement plans in 2016.<sup>63</sup> The government estimates that the new retirement plans could add an additional \$173 million to the pension fund. Territory officials said the government is meeting its actuarial contributions on an annual basis and is on track to pay off the existing unfunded pension liability in approximately 15 years.<sup>64</sup>

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<sup>60</sup>The Naval Facilities Engineering Command Pacific, *Socioeconomic Impact Assessment Study: Guam and CNMI Military Relocation* (Washington, D.C.: December 2014).

<sup>61</sup>A defined benefit plan promises a specified monthly benefit at retirement. The plan may state this promised benefit as an exact dollar amount, such as \$100 per month at retirement. Or, more commonly, it may calculate a benefit through a plan formula that considers such factors as salary and service.

<sup>62</sup>A defined contribution plan does not promise a specific amount of benefits at retirement. In these plans, the employee, the employer, or both contribute to the employee's individual account under the plan, sometimes at a set rate, such as 5 percent of earnings annually. These contributions generally are invested on the employee's behalf. The employee will ultimately receive the balance in their account, which is based on contributions plus or minus investment gains or losses. The value of the account will fluctuate due to the changes in the value of the investments.

<sup>63</sup>Guam Pub. L. 33-186 (Sept. 14, 2016).

<sup>64</sup>We did not independently confirm this estimate.

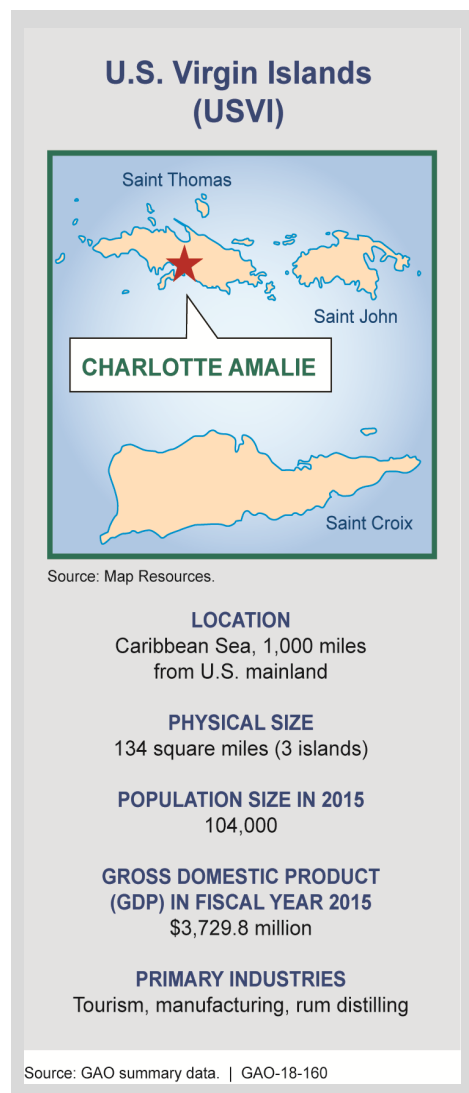
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## United States Virgin Islands (USVI)

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### USVI's Total Public Debt Nearly Doubled and Grew from 32 to 72 Percent of GDP between Fiscal Years 2005 and 2015

#### Total Public Debt Outstanding



Between fiscal years 2005 and 2015,<sup>65</sup> USVI's total public debt outstanding grew by 84 percent, from \$1.4 billion to \$2.6 billion.<sup>66</sup> (See figure 19.) The sharpest increase was between fiscal years 2008 and 2010. During this period, total public debt outstanding increased by about \$800 million, and almost all of USVI's public debt was in the form of bonds. Bonds issued by USVI's primary government are either backed by 1) both a general obligation of the government and a gross receipts tax, or 2) an excise tax on rum produced in USVI.<sup>67</sup> Bonds issued by component units are backed by their revenues. Approximately half of USVI's bonded debt is backed by revenues generated from the excise tax placed on rum imports to the U.S. mainland. Both the primary government and component units issued notes and took out loans during this period. Most of USVI's bonded debt outstanding is scheduled to mature in 2027 or afterward.

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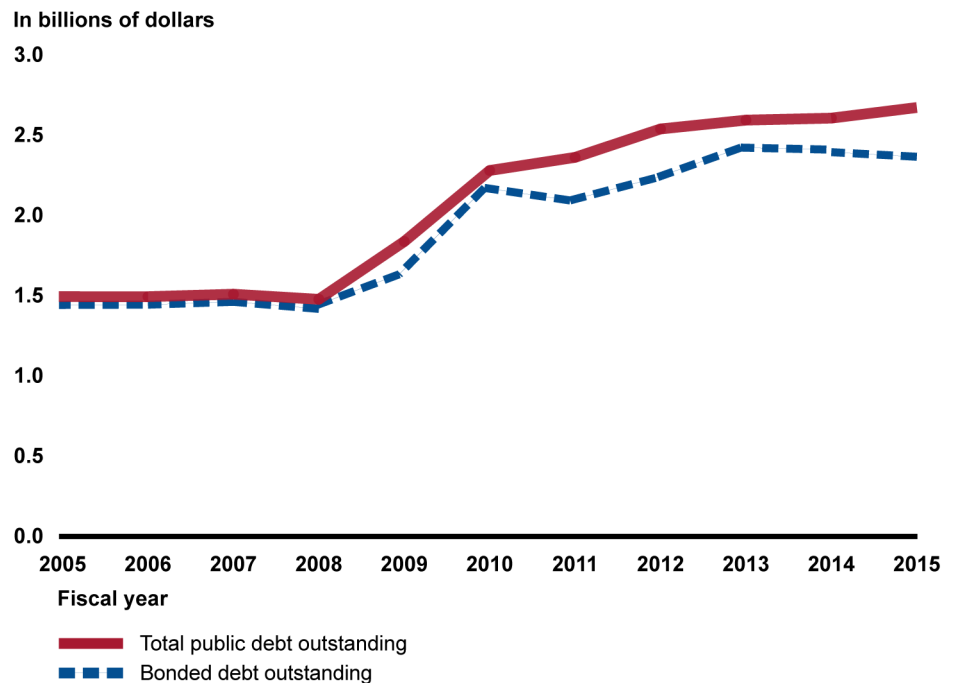
<sup>65</sup>Since the period covered in this report ends with fiscal year 2015 or 2014 (for Puerto Rico), it does not include any cost or impacts from the 2017 hurricanes.

<sup>66</sup>In fiscal year 2015, 15 percent of USVI's total public debt outstanding was issued by component units.

<sup>67</sup>The excise tax is a federal tax collected by the U.S. Treasury. Proceeds from the tax on USVI-produced rum are refunded to the USVI government in accordance with a statutory formula. 26 U.S.C. § 7652. These rebated funds are known as matching funds and bonds backed by these funds are referred to as "matching fund bonds."



**Figure 19: U.S. Virgin Islands' (USVI) Bonded Debt Outstanding as a Component of Total Public Debt Outstanding, Fiscal Years 2005-2015**



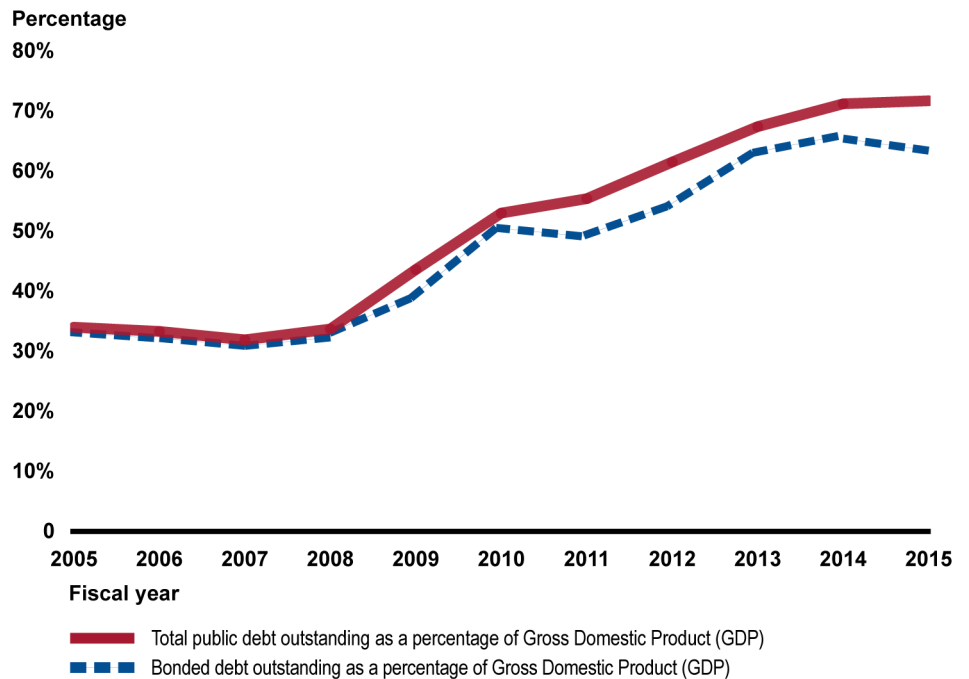
Source: GAO analysis of USVI single audit reports for fiscal years 2005-2015. | GAO-18-160

Note: Public debt outstanding includes debt issued by the primary government and component units as enumerated in the single audit reports.

## Public Debt as a Share of GDP

USVI's total public debt outstanding as a percentage of GDP doubled between fiscal years 2005 and 2015, growing from 34 percent to 72 percent. The steepest increases were between 2008 and 2010, when total public debt outstanding as a percentage of GDP increased by 19 percent, and between 2011 and 2014, when it increased by 16 percent. Total public debt outstanding as a share of GDP reached 72 percent in fiscal year 2015. Bonded debt outstanding was 63 percent of GDP in fiscal year 2015. (See figure 20.)

**Figure 20: U.S. Virgin Islands' (USVI) Public Debt Outstanding as a Share of GDP, Fiscal Years 2005-2015**



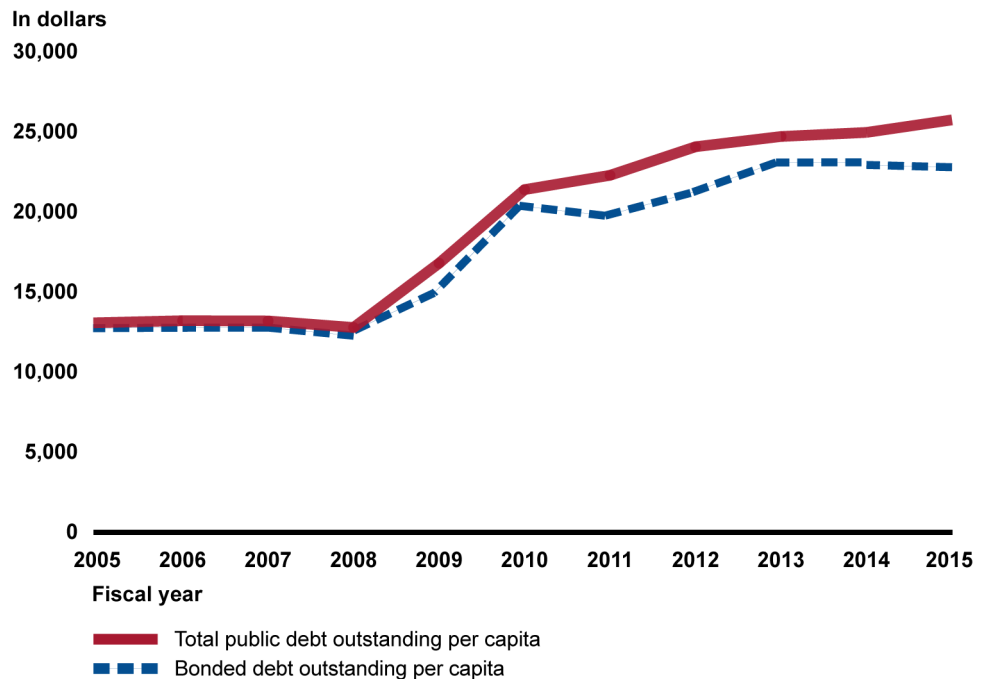
Source: GAO analysis of USVI data. | GAO-18-160

Note: Public debt outstanding includes debt issued by the primary government and component units as enumerated in the single audit reports.

## Public Debt Per Capita

Total public debt outstanding per capita also increased during this period. It ranged from about \$13,063 per person in fiscal year 2005 to about \$25,739 per person in fiscal year 2015. (See figure 21.)

**Figure 21: U.S. Virgin Islands (USVI) Public Debt Outstanding Per Capita, Fiscal Years 2005-2015**



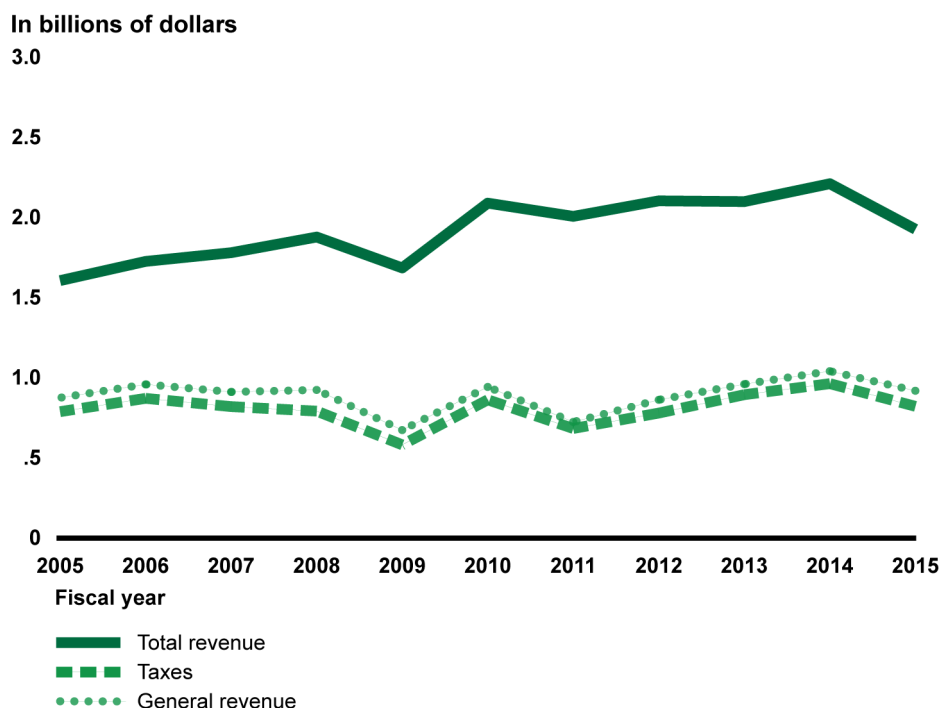
Source: GAO analysis of USVI data. | GAO-18-160

Note: Public debt outstanding includes debt issued by the primary government and component units as enumerated in the single audit reports.

## USVI's General Revenue Remained Stagnant and Net Position Was Generally Declining between Fiscal Years 2005 and 2015

USVI's general revenue showed almost no growth in the 10-year period between fiscal years 2005 and 2015. USVI's general revenue declined from fiscal years 2008 to 2009 due to the 2008 recession and operating losses at the Hovensa oil refinery, and rebounded in fiscal year 2010 as the economy recovered. General revenue decreased again from fiscal year 2010 to 2011. Between fiscal years 2011 and 2014 revenue increased again. Despite the increase, the fiscal year 2015 general revenue of \$919.4 million was only about \$43 million greater than that collected 10 years prior. In contrast USVI's total revenue (i.e. general revenue and program revenue combined) grew slightly by 2 percent on average, per year, between fiscal years 2005 and 2015, from \$1.6 billion to \$1.9 billion. (See figure 22.)

**Figure 22: U.S. Virgin Islands' (USVI) Revenue, Fiscal Years 2005-2015**



Source: GAO analysis of USVI single audit reports for fiscal years 2005-2015. | GAO-18-160

Note: Revenue includes general revenue and program revenue generated by the primary government and component units as enumerated in the single audit reports. Taxes are part of general revenue.

USVI has a statutory requirement that a team, composed of senior executives and legislative officials, meet at least twice a year to establish an official economic forecast of the territorial economy, including estimates of the following year's revenue.<sup>68</sup> Territory officials acknowledged that in recent years actual revenues have been less than had been estimated, citing both adverse economic conditions and litigation that had blocked the collection of property taxes for several years. These officials said that a new estimation methodology has been devised which uses a weighted average of the prior 5 years of actual revenue.

USVI's net position for the primary government declined year over year from a negative \$215.0 million as of fiscal year end 2008 to a negative

<sup>68</sup>2 V.I.C. § 20d.

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\$1.5 billion as of fiscal year end 2014; continuing to decline to a negative \$3.7 billion as of fiscal year end 2015.<sup>69</sup> USVI's net position for the primary government as of fiscal year end 2014 is shown prior to restatement implementing GASB Statement No. 68. In fiscal year 2015, USVI implemented GASB Statement No. 68 and adjusted its beginning net position by \$2.0 billion, resulting in a restated net position as of fiscal year end 2014 of a negative \$3.5 billion. The implementation of GASB Statement No. 68 resulted in the territory recognizing previously unrecognized net pension liabilities and, therefore, a decline in ending net position in the year of recognition. USVI's declining net position for its primary government reflects its deteriorating financial position.

USVI's total net position for the primary government and component units combined increased between fiscal year end 2005 and 2007; it then declined year over year from positive \$490.9 million as of fiscal year end 2008 to negative \$3.6 billion as of fiscal year end 2015.

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**Since 2010, USVI's Public Debt Has Been Used Primarily for General Government Operations**

More than a third of USVI's current bonded debt outstanding as of fiscal year 2015 was issued to fund government operating costs. Before that time bonded debt outstanding issued on behalf of the primary government was used either to refinance earlier bond issues; fund infrastructure projects such as improvements to schools, public safety facilities, and transportation infrastructure; or to assist privately-owned industrial enterprises, specifically construction at the Cruzan and Diageo rum distilleries and payment of a portion of the costs of sewage and solid waste disposal at the Hovensa oil refinery.

In the period following the recession of 2008, revenues declined and there were continuing demands for spending. In response, USVI issued debt for the purpose of financing regular government operating expenses. Between July 2010 and December 2014, USVI issued almost \$850 million

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<sup>69</sup>USVI's net position for the primary government fluctuated between fiscal years 2005 and 2007. As of fiscal year end 2005, USVI's net position for the primary government was a negative \$137.5 million. In fiscal years 2006 and 2007, USVI's net position improved, resulting in year-end balances of negative \$14.4 million and positive \$36.2 million, respectively. However, USVI's net position declined in fiscal year 2008 to a year-end balance of negative \$215.0 million.

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in bonds for this purpose with maturities ranging between 1 and 20 years.<sup>70</sup>

According to territory officials, several factors contributed to USVI's increasing reliance on debt to fund government operations, including the recession of 2008, the 2012 closure of the Hovensa oil refinery, a decline in USVI's share of worldwide rum sales, and a decline in visits from cruise ship passengers. According to a senior government official, the closure of the Hovensa refinery was particularly detrimental to the territory's economy and resulted in the loss of 2,000 jobs on St. Croix and a significant decrease in revenue. As of April 2017, USVI's unemployment rate was 10.3 percent.

USVI officials cited several federal requirements that contributed to USVI's need to issue debt. Because USVI is part of the mirror tax code, officials noted that USVI is required to pay the EITC to its residents, but is not reimbursed for this by the federal government. In contrast, state governments do not pay EITC because it is a federal benefit administered through the federal tax code.<sup>71</sup> EPA directives for improving landfills and water projects and federal banking regulations that treat branches of U.S. banks placed in USVI as non-U.S. banks—thereby discouraging large banks from having branches in USVI—were also cited as reasons that USVI has issued debt.

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### Economic Uncertainty and Large Fiscal Risks May Significantly Limit USVI's Ability to Repay Public Debt

USVI officials expressed confidence in the territory's ability to repay public debt, but we found that large fiscal risks and exclusion from capital markets may hamper its ability to do so. USVI's bonds are backed by the gross receipts tax on some individuals and entities doing business in USVI and by excise tax revenues collected by the federal government and remitted to USVI as required by statute.<sup>72</sup> Officials said that revenues from the gross receipts tax and excise tax rebates—from which debt service payments are made—are monitored on a month-by-month basis. Also, officials cited as a protection against default the “lockbox” provisions

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<sup>70</sup>During this period, two component units, the USVI Port Authority and USVI Water and Power Authority, issued \$237 million in bonds for refinancing of previously issued debt and financing of capital projects.

<sup>71</sup>State residents also pay both federal income taxes and any state income taxes, unlike USVI residents.

<sup>72</sup>26 U.S.C. § 7652.

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that USVI has had contractually for some time and that were written into its statutes in 2016.<sup>73</sup> According to these provisions, gross receipts tax and excise rebate revenue go directly to an escrow account in a New York bank, and the escrow agent makes debt service payments twice a year from the account; a year's worth of payments is held in reserve at all times.

USVI officials expressed confidence that these provisions make it difficult for USVI to default on its debt payments. However, in a recent statement, Moody's rating service said that these security provisions have not been tested in a stress scenario where the government faces a lack of funds to provide basic services. This observation was part of a statement issued by Moody's in late January 2017 in which it announced it had downgraded USVI's matching fund bonds (those backed by excise tax rebates) to noninvestment grade.<sup>74</sup>

Other rating agencies expressed similar concerns. For example, Standard & Poor's cited 1) the government's fiscal distress, as evidenced by its significant structural imbalance and continued reliance on deficit financing to fund operations; 2) revenue backed bond issues that have exhibited either declining or flat growth absent tax rate increases and are levied on a limited and concentrated base; 3) adequate, but substantially reduced, debt service coverage; and 4) a limited economy, concentrated in rum production, tourism, and government.

In late January 2017, USVI cancelled a new bond issuance it was attempting to market to provide additional financing for general government operations. The bond issuance was authorized by the USVI legislature in 2016, but according to a senior bank official involved in underwriting USVI bonds, delays in bringing the issuance to market, and the legislature's delay in enacting so-called "sin taxes" on items such as beer, cigarettes, and liquor, reduced the chances of successfully marketing the bond issue to investors. By the time USVI made an effort to market the bonds in late 2016 and January 2017, the Puerto Rico debt crisis had increased investors' concerns about USVI's debt as well. The rating downgrades of existing USVI debt, while not the decisive factor

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<sup>73</sup>2016 V.I. Sess. Laws 7951, § 1(D) (Nov. 7, 2016).

<sup>74</sup>Moody's action followed downgrading of USVI matching fund and gross receipt bonds by Standard & Poor's in early December 2016 and was followed by a downgrading from Fitch in early January 2017.

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according to the bank official, did reinforce existing skepticism on the part of potential investors. Ultimately, the early 2017 bond issuance was not adequately subscribed and the offer failed. USVI effectively lost market access to new debt even at high interest rates.

In September 2016, the administration released its 5-year financial plan. The two major features of this plan were a reduction in government expenditures by limiting hiring and reducing non-personnel costs, and a proposal for increasing revenue through taxes on beer, rum, wine, brandy, sugar-laden carbonated beverages, and cigarettes, among other revenue generating measures. The legislature passed the tax increase bill, with some modification of the Governor's proposal, in early March and the Governor signed it into law on March 22, 2017.

In the 5-year financial plan, the administration said that adopting austerity and tax measures would eliminate future deficits, which otherwise would amount to more than \$130 million for each fiscal year between 2017 and 2021. A senior USVI official expressed a belief that the level of consumption of cigarettes, for example, will remain at pretax levels despite the higher cost. However, due to elasticity of demand, an increase in the price of cigarettes could decrease cigarette consumption and therefore revenues. If the tax increases do not produce the anticipated level of revenue, and if USVI is not able to regain access to capital markets, it will place even more stress on the debt service arrangements currently in effect.

Moreover, the recent measures do not address the fiscal risk presented by unfunded pension liabilities and OPEB for government employees. USVI reported an unfunded pension liability of over \$3 billion, which was 83 percent of GDP in fiscal year 2015.<sup>75</sup> According to an independent consulting firm's August 2016 report conducted for the USVI Government Employees Retirement System, the retirement fund will become insolvent in 2023 without adding financial resources and adjusting benefit levels.<sup>76</sup>

Territory officials cited several reasons for the large unfunded pension and OPEB benefit liabilities. These include recent legislation that resulted

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<sup>75</sup>This estimate was \$1 billion greater than the estimate for the previous year, owing to a change in accounting standards reducing the discount rate used in preparing the liability estimate.

<sup>76</sup>Upon insolvency, the projected contributions are expected to cover only about half of the projected benefits and expenses.



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in more retirees eligible for pensions and a decline in the active USVI government workforce that resulted in a narrower ratio of retirees to workers, dropping from 6-to-1 in fiscal year 1982 to almost 1-to-1 in fiscal year 2015. In addition, officials told us that the most significant cause for the current condition of the retirement system is the primary government making contributions to the system below the amounts required by law.<sup>77</sup>

Some measures have been taken to address the retirement fund's impending insolvency, and other steps have been recommended. According to territory officials, USVI law changed in 2005, resulting in increased required pension contributions from all newly hired employees except for judges and legislators. In 2013, a Pension Reform Task Force (Task Force) recommended legislation that would 1) increase government and employee contributions towards pension benefits, 2) raise contribution rates for senators and judges, 3) reduce retiree current benefits by 10 percent, 4) increase the early retirement age from 50 to 55 and the regular retirement age from 60 to 65, 5) limit cost of living increases, and 6) change the formula used to calculate benefits.

In October 2015, the Legislature enacted and the Governor signed legislation that raised retirement ages for some employees, changed the basis for determining pension levels to career earnings, and allowed the retirement system to invest funds in lower-rated securities.<sup>78</sup> This did not, however, address most of the Task Force recommendations. Territory officials told us that the administration will put forward additional pension reform proposals in the near future, however it remains unclear what those reforms will entail and when they will take effect.

Moreover, territory officials told us that since 2011 the government has paid less than half of actual post-employment benefit costs, leaving an unpaid current obligation of \$357 million as of fiscal year 2015. The unfunded liability for post-employment benefits, projecting anticipated future costs, was most recently calculated in October 2013; at that time it was just over \$1 billion. USVI's pension and OPEB obligations are

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<sup>77</sup>In September 2015, the retirement system submitted an invoice to the primary government stating that of \$2.67 billion in actuarially required employee contributions from 1991 through 2015, the central government had paid \$1.39 billion, leaving \$1.28 billion unpaid. The primary government underpaid the full actuarial amount, but paid most of the amount through 2001; after that, the government paid half or less than half of the required amount, with less than 38 percent being paid between 2012 and 2015.

<sup>78</sup>2016 V.I. Sess. Laws 7802, § 1(D) (Nov. 7, 2016).

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already contributing to the territory's debt burden, and will likely continue to do so at an increasing rate. If unaddressed, they may place additional stress on the debt service arrangements currently in effect and hamper the territory's ability to repay debt.

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## Agency Comments, Third Party Views, and our Evaluation

We provided a draft of this report for review to the U.S. Departments of the Interior and Treasury. We also provided, to the governments of Puerto Rico, American Samoa, the Commonwealth of the Northern Mariana Islands (CNMI), Guam, and the United States Virgin Islands (USVI), portions of the draft that were relevant to them. We received written comments from each of the five territories' governments, which are reprinted in appendixes II, III, IV, V, and VI, respectively. We also received technical comments from American Samoa, Guam, USVI, and Treasury, which we incorporated as appropriate. We did not receive any comments from the Department of the Interior. In the letter from the Governor of Guam, the territory raised some issues, which we subsequently discussed in depth with territory officials. Following these discussions, we made modifications to the draft to provide additional context by broadening our coverage of revenue for Guam and for other territories, as applicable. We provide additional information about changes that we made or did not make at the end of Appendix V.

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We will provide copies of this report to the Governor of each territory and the U.S. Secretaries of the Interior and Treasury. In addition, the report will be available at no charge on the GAO website at <http://www.gao.gov>.

If you or your staffs have questions about this report, please contact Susan J. Irving at (202) 512-6806, or David Gootnick at (202) 512-3149. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made key contributions to this report are listed in appendix II.



Susan J. Irving  
Director, Strategic Issues



David Gootnick  
Director, International Affairs and Trade

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# Appendix I: Objectives, Scope, and Methodology

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Our objectives were, for each U.S. territory—Puerto Rico, American Samoa, the Commonwealth of the Northern Mariana Islands (CNMI), Guam and the U.S. Virgin Islands (USVI)—to describe: (1) trends in public debt and its composition between fiscal years 2005 and 2015, (2) trends in revenue and its composition between fiscal years 2005 and 2015, (3) the major reported drivers of the territory's public debt, and (4) what is known about the ability of the territory to repay public debt.<sup>1</sup>

For the purposes of this report, total debt held by the public (public debt) refers to the sum of bonds payable and other debt payable as described in the audited financial statements included within the territories' single audit reporting packages<sup>2</sup>, hereinafter referred to as the single audit reports. Bonds payable are marketable bonded debt securities issued by territorial governments or their component units and held by investors outside those governments. Other debt payable may include marketable notes issued by territorial governments and held by investors outside those governments; non-marketable intragovernmental notes; and notes held by local banks, federal loans, intragovernmental loans, and loans issued by local banks. Pension liabilities and other post-employment benefits (OPEB) are not included in the definition of total public debt but are considered and discussed in the sections of the report that describe the territories' ability to repay their public debt.

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<sup>1</sup>Since the period covered by this performance audit is fiscal years 2005 through 2015, it does, it does not capture any costs or other impacts from the 2017 hurricanes.

<sup>2</sup>The Single Audit Act, as implemented by Office of Management and Budget Circular No. A-133, requires nonfederal entities that expend above a dollar threshold in federal awards in a fiscal year to have a single audit. For the years whose audited financial statements we reviewed, the applicable threshold was \$500,000 or more. Beginning in fiscal year 2015, the threshold was raised to \$750,000. Federal awards include grants, loans, loan guarantees, property, cooperative agreements, interest subsidies, insurance, food commodities, direct appropriations, other assistance, and federal cost-reimbursement contracts. Single audits are audits of the recipient organization—the government in the case of the territories—that focus on the recipient's internal controls and its compliance with laws and regulations governing federal awards. As nonfederal entities expending more than \$750,000 a year in federal awards, the territories are required to submit single audit reports. Recipient organizations are required by the act to submit their single audits reports to the Federal Audit Clearinghouse (FAC). The single audit reporting package sent to the FAC includes (1) the auditor's reports; (2) the entity's audited financial statements and related notes; (3) the schedule of expenditures of federal awards, related notes, and the auditor's report on the schedule; (4) a schedule of findings and questioned costs; (5) reports on internal controls over financial reporting, and compliance with laws and regulations; and (6) a summary schedule of prior audit findings.

To describe trends in public debt and its composition for each territory, we reviewed the territories' single audit reports. These single audits are conducted each year by independent accounting firms in accordance with government accounting standards. We obtained single audits for American Samoa, CNMI, Guam, and USVI for fiscal years 2005 through 2015. We also obtained and analyzed consolidated audited financial statements for Puerto Rico from the Commonwealth of Puerto Rico's Treasury Department website for fiscal years 2005 through 2014.<sup>3</sup> For each territory, we reviewed the independent auditor's report corresponding to each single audit and noted the type of opinion that was expressed on the financial statements and accompanying note disclosures.<sup>4</sup> With the exception of Puerto Rico, each of the territories received modified opinions by auditors on one or more of the single audit reports included in our analysis. We reviewed each of these opinions and determined that despite the modified opinions the data we obtained from each of the single audit reports was reliable for the purpose of describing trends in debt and revenue and their composition for the fiscal years included in our analysis.<sup>5</sup>

For each territory, we extracted information on public debt—specifically bonds, loans, and notes for both the primary government and component units—for each fiscal year and recorded the data on spreadsheets, which were then independently verified by other analysts. For American Samoa, CNMI, Guam, and USVI, we calculated debt per capita and debt as a percentage of nominal Gross Domestic Product (GDP)<sup>6</sup> using nominal GDP and population data from the U.S. Department of Commerce's Bureau of Economic Analysis. For Puerto Rico, we obtained data on

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<sup>3</sup>Puerto Rico's consolidated audited financial statement for 2015 was not available as of June 2017. Officials anticipated it would be released by September 2017.

<sup>4</sup>Auditors express unmodified opinions when the auditors conclude that the financial statements are presented fairly, in all material respects, in accordance with the applicable financial reporting framework. Auditors express modified opinions when (1) the auditors conclude that, based on the audit evidence obtained, the financial statements as a whole are materially misstated or (2) the auditors are unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement. A modified opinion can be expressed as a qualified opinion, an adverse opinion, or a disclaimer of opinion.

<sup>5</sup>Appropriateness is the measure of the quality of evidence that encompasses its relevance, validity, and reliability in providing support for findings and conclusions related to the audit objectives.

<sup>6</sup>GDP was adjusted for fiscal years.

Gross National Product (GNP) and nominal GDP from the Commonwealth of Puerto Rico Office of the Governor's Planning Board<sup>7</sup> and data on population from the U. S. Census Bureau.

To identify trends in revenue and its composition for each territory, we obtained and recorded information from the single audit reports on general revenues.<sup>8</sup> All tax revenues, including tax revenues that are dedicated to particular purposes, are reported in general revenues. Tax revenues represent the largest component of general revenues and include both derived tax revenues (resulting from assessments imposed on exchange transactions, such as income taxes and sales taxes) and imposed nonexchange revenues (resulting from assessments imposed on non-exchange transactions, such as property taxes and fines). General revenues also include other forms of revenue, such as unrestricted aid from other governments and investment earnings. Our analysis primarily focused on trends in general revenues because the territories' public debt is either explicitly or implicitly backed by general revenues. We also included total revenue—general revenues and program revenues<sup>9</sup> combined—in our analysis because it reflects revenue generated by the territories' component units and could be used to service debt payments.

In addition to general revenue levels, another measure of fiscal health is the net position for primary government activities, which represents the difference between the primary government's assets (including the deferred outflows of resources) and the primary government's liabilities (including the deferred inflows of resources). In other words, the net position for primary government activities reflects what the primary government would have left after satisfying its liabilities. A negative net position means that the primary government has more liabilities than assets. A decline in net position may be indicative of a deteriorating financial position. While our analysis primarily focuses on trends in the net position for the primary government, we also include certain information

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<sup>7</sup>We did not independently verify the accuracy of these data.

<sup>8</sup>General revenue includes revenue generated by both the primary government and component units.

<sup>9</sup>Program revenues are directly linked to functions or programs and include charges for services, as well as grants and contributions for specific functions and programs. While program revenues are generated by the associated functions or programs, such revenues are not always restricted to use in those functions or programs.

on trends in the total net position for the primary government and component units combined.

To determine the major reported drivers of public debt and what is known about the territories' ability to repay this debt, we interviewed officials from the territories' governments, including officials from the Governors' offices, departments of finance or treasury, and the agency responsible for issuing and marketing bonded debt. We also spoke to officials in territorial public audit offices. In addition, we interviewed representatives of the three rating agencies that provide credit ratings for the territories' securities: Fitch, Moody's, and Standard and Poor's.

In addition, to determine what is known about the territories' ability to repay public debt we analyzed common factors—identified through prior work, documents, and interviews with the three rating agencies—that indicate territories' potential vulnerability to debt crises. These factors included 1) the extent to which territories consistently issued debt to fund general government operations, 2) the extent to which territories' economies were vulnerable to shocks due to a heavy dependence on a single or limited industry, and 3) the extent to which territories faced large fiscal risks such as pension liabilities.

We also interviewed officials from the Department of the Interior's Office of Insular Affairs, which provides grant aid and technical assistance and support to the territories, and the Pacific and Virgin Islands Training Initiatives, which provides training and technical assistance on fiscal management to the Pacific territories and USVI, and directs the preparation of an annual report on the fiscal condition of these territories. In addition, we spoke with subject matter experts on territorial debt, officials from an investment bank involved in underwriting the territories' bonds, and officials from the three rating agencies that rate the marketability of the territories' bonds.

We obtained and reviewed information on territorial bond issuances from fiscal years 2005 through 2015 from the Electronic Municipal Market Access (EMMA) database of the Municipal Securities Rulemaking Board, the primary regulator of the municipal securities market. We reviewed information from EMMA on bonds issued by the territories from fiscal years 2005 through 2015, including memoranda of offering for individual bond issuances.

We conducted this performance audit from September 2016 to October 2017 in accordance with generally accepted government auditing

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standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained for the purpose of addressing our audit objectives provides a reasonable basis for our findings and conclusions.



# Appendix II: Comments from the Government of Puerto Rico



GOVERNMENT OF PUERTO RICO

Federal Affairs Administration

August 16, 2017

The Honorable Gene L. Dodaro  
Comptroller General of the United States  
U.S. General Accountability Office  
441 G Street, N.W.  
Washington, DC 20548

Dear Mr. Dodaro,

I am writing with regards to the U.S. Government Accountability Office (GAO) report, GAO-17-689, *U.S. Territories Public Debt Outlook*. Thank you for the opportunity to review and comment on the report in draft form. This report will inform the public policy debate surrounding issues of critical importance to Puerto Rico and the other U.S. territories.

Below are the official comments and feedback of the Government of Puerto Rico.

## **Factors that Have Contributed to Puerto Rico's High Debt Levels**

As the GAO analyzes the factors that have contributed to the excessive debt levels in Puerto Rico it should look at the undemocratic, unequal and oftentimes arbitrary federal legal, regulatory and constitutional frameworks that apply to the island as a U.S. territory.

- **Utilization of Debt to Pay for General Expenses:** Although the assertion by the credit rating agencies that the Government of Puerto Rico has over the last couple of decades utilized proceeds from debt issuance to pay for operational expenses might be correct, it is essential to understand why this is the case. Under Puerto Rico's territorial status Congress can and does treat the island unequally under multiple federal laws, programs (such as Medicaid, Medicare, Highway funding, Earned Income Tax Credit), and many other policies. This means that the Government of Puerto Rico cannot count on the same amount of federal support that state governments receive and is expected to perform economically in an uneven playing field. The inequitable policies also lead to an overall quality of life in Puerto Rico that is below the standard in the states in multiple respects. Given the mobility of Puerto Rico residents, which as U.S. citizens can travel freely between the island and the states, and the growing population of stateside Puerto Ricans, the voting population in the island is keenly aware of the discrepancy in quality of life. As one would expect from rational persons, voters in Puerto Rico aspire to attain a standard of living in the island equal to that afforded to our fellow citizens in the states. Therefore, the federally-created situation of structural inequality combined with citizen mobility, generates significant political pressure on Puerto Rico's elected officials to spend beyond the territory's means to meet the expectations and aspirations of the citizenry. While this does not make the decision to use debt spending to finance recurring deficits either good policy or a sustainable practice, it does show that this behavior is not happening in a vacuum. It has taken place within a framework of federal laws and policies that discriminate against U.S. citizens because of where they are born and or where they choose to live. Another

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factor that must be considered is the imposition of federal laws and regulations that amount to unfunded mandates, where the Government of Puerto Rico is expected to make capital investments or provide certain services to its constituents, yet the level of federal support to accomplish these oftentimes laudable goals is woefully insufficient. Examples of this include the types of benefits that Puerto Rico is required to provide its Medicaid population, and the Environmental Protection Agency's Mercury and Air Toxic Standards emission standards that the Puerto Rico Electric Power Authority is required to meet under the Clean Air Act.

- **Triple Tax Exempt Status:** The triple tax exempt status of bonds issued by the Government of Puerto Rico and its instrumentalities exists only because federal law and policy permit it. While it is true that the issuance of debt at favorable rates postponed implementation of Puerto Rico's fiscal reforms, this is because federal law and policy allowed the territory to issue bonds on different terms than the states can issue. Although the triple tax exempt status can be considered a benefit that the federal government grants the territories, its existence is attributable to some extent to the understanding by federal policymakers that the territory is subject to an unfair legal framework, particularly in terms of reduced levels of funding and various other areas of disadvantageous federal treatment. Therefore, the supposed benefit to the territory ends up being a significant risk and liability to the extent to which it facilitates and promotes the utilization of debt at levels above what a comparable state jurisdiction would be able to sustain, since those other jurisdictions would be limited in their overutilization of debt much earlier by the much higher interest rates. Additional federal policies that GAO should also factor into the analysis of Puerto Rico's inordinate acquisition of debt include the arbitrary and unexplained removal of Chapter 9 bankruptcy protection for the territory, as well as the island's exclusion from the Investor Protection Act.
- **Population Exodus:** While the mention of outmigration in the report is placed only in the context of the island's economic recession, there are multiple other factors of great significance that have spurred the current historic wave of migration of U.S. citizens moving from Puerto Rico to the states. These include citizens seeking full and equal treatment under federal laws and programs, citizens seeking full voting rights and representation in the federal government that makes the laws that they live under, and people seeking improved security, healthcare, and education which are unavailable to them in Puerto Rico because of the undemocratic and unequal treatment the island gets as a territory. The impact of this exodus goes beyond just a reduction in tax revenue. It also limits Puerto Rico's prospects for economic growth based on a reduced labor force as well as reduced aggregate demand within the local economy. The exodus also limits the island's ability to compete for new investments and economic opportunities. What these observations reveal is a self-reinforcing negative feedback loop where territorial inequality and a lack of cohesiveness in federal policies toward Puerto Rico limits the island's prospects for economic growth and encourages taking on excessive debt levels. This in turn spurs outmigration from the island which further erodes the economy, as well as the tax base, limiting the repayment capacity of the jurisdiction. This is particularly problematic because when Puerto Rico residents leave the island their share of the debt must

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be reallocated among the smaller population that remains behind, increasing the proportional share of debt per individual.

- **Phase Out of Section 936 Tax Credit:** The Puerto Rican economy has been in a decline process since the mid-1970s, nearly around the same time when tax credits of Section 936 were enacted by Congress, and continued unabated throughout the entire time the section was in place. Before their phase-out concluded in 2006, excessive debt levels were already present in Puerto Rico. The audited financial statements show that the Government of Puerto Rico began to use debt to finance its budget deficits in the period from 2001 to 2005. This being the case it is hard to argue that the repeal and phase-out of Section 936 was a principal factor in increasing government debt, particularly since the companies operating under this section were not subject to local taxes on their income earned in Puerto Rico. Even though some argue Section 936 companies were the saving grace of Puerto Rico's economy, the fact is that their existence did not alter the trend of economic decline, which had persisted before, during and after Section 936. By enacting Section 936 Congress created a federal policy framework that benefitted subsidiaries of national corporations at the expense of American taxpayers. What Puerto Rico needs is not a replacement for Section 936, instead Congress should enact a policy framework to help grow a robust, diverse and resilient local economy that maximizes the competitive advantages of the island.

**Outlook for Repayment of Debt**

As the GAO discusses the factors that will determine the capacity of the Government of Puerto Rico to repay its debts, it should extend its analysis beyond the outcome of the Title III process in federal court. Irrespective of the level of debt restructuring provided for in the Title III process, an even greater factor in the capacity of the Government of Puerto Rico to be able to pay back its debts will be economic growth.

- **Local Pro-Growth Reforms:** There are various factors impacting Puerto Rico's prospects for stopping the ongoing economic decline and restoring economic growth. One of them is the Government of Puerto Rico's efforts to implement policies reforming government structures to create a more business-friendly climate on the island, that can allow existing businesses to grow, attract investment and capital from the states and abroad, and utilize these to generate more jobs and economic activity. This in turn can help slow or eventually reverse the population exodus. Toward this end the current administration in Puerto Rico has worked to implement permitting reforms, labor reforms, expand use of public private partnerships, incentives reform, created a destination marketing organization, established Enterprise Puerto Rico, and is currently working on a tax reform among other major local policy changes. While much more remains to be done, the Government of Puerto Rico is doing everything that it can at the local level to create the conditions for restoring economic growth.
- **Implementation of Fiscal Control Measures & Government Restructuring:** Another principal factor impacting Puerto Rico's prospects for economic growth is whether the Financial Oversight and Management Board for Puerto Rico (the "Oversight Board") works

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constructively with the Government of Puerto Rico to moderate the significant austerity measures it has imposed in the certified Fiscal Plan and approved budgets. The actions that the Oversight Board requires of Puerto Rico should always consider what their impact will be on the territory's capacity to retain its population and re-ignite the engine of economic growth on the island. Excessive or carelessly imposed austerity measures could unintentionally jeopardize Puerto Rico's prospects for economic growth, its capacity to retain population, and increase outmigration thereby further limiting the island's capacity to repay its debts. The Oversight Board must ensure that the corrective measures it imposes do not unintentionally make a bad situation significantly worse for both the American citizens residing in Puerto Rico, bondholders, and the federal policymakers in Congress that bear ultimate responsibility for the territory under Article 4, Section 3 of the U.S. Constitution. One example of a proposal by the Oversight Board that could be very counterproductive is the implementation of government wide furloughs on public employees to increase liquidity at a time when the Government of Puerto Rico has shown that it has the liquidity level that is required by the approved Fiscal Plan. The unnecessary implementation of such a measure at this critical juncture would inevitably weaken consumer demand further, reduce tax revenues, increase foreclosures, and possibly push some key public employees out of government in an untimely way thereby delaying the ongoing government reform and rightsizing efforts that are working to make government more effective and cost efficient.

- **Congressional & Executive Actions to Address Critical Challenges:** The report issued by the Congressional Task Force on Economic Growth in Puerto Rico identified a variety of policy recommendations for Congress and the federal Executive that could help address critical challenges in Puerto Rico and support the restoration of economic growth on the island. Whether Congress and the Executive work with the Government of Puerto Rico to act on the challenges and opportunities identified by the Task Force could make a very big difference in improving the conditions for economic growth to take place in the territory. Some of these challenges, such as the sudden drop in federal Medicaid funding which is expected to take place early next year or the determination of creditability by the U.S. Internal Revenue Service for Puerto Rico Act 154 of 2010, are well known in Congress and in the Executive and could have an immense impact on Puerto Rico's debt repayment capacity under the certified Fiscal Plan.
- **Resolution of Undemocratic & Unequal Territorial Status:** The question of Puerto Rico's ultimate political status and relationship with the Federal Government is intimately linked to the island's prospects for economic growth, and therefore its capacity to repay its debts. By allowing Congress and the federal Executive Branch to treat Puerto Rico differently and in ways that discriminate against the island and its residents, the current territorial status inherently limits economic growth. It does this by allowing the propagation of federal laws and policies toward the territory that lack the coherence and consistency required to provide for the island's sustained economic development and growth. The democratic deficit generated by the lack of voting representation at the federal level results in an inability of the elected officials from Puerto Rico to exert sufficient influence in the federal policy and regulatory making

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process to be able to ensure that the island's needs, conditions and aspirations are duly considered and accounted for. Unfortunately, federal policy towards the island is oftentimes executed as an afterthought and without a proper understanding of the circumstances of the island and its residents. There are countless examples of federal policies and practices that harm or limit Puerto Rico's economic development potential. Among these are the disparate treatment and sometimes-outright exclusion of Puerto Rico from a variety of federal programs (e.g. the Enterprise Zones program), the island's exclusion from a multitude of federal studies and statistics, the disproportionately low level of federal procurement from businesses in Puerto Rico, and unnecessary regulations that limit interstate commerce such as the Electronic Export Information requirement. Another factor that negatively impacts the island's economy is the significant levels of political and policy uncertainty and risk created by the territorial status at both the local and federal levels. For businesses making investment decisions this political and policy risk decreases the desirability of making investments on the island and it also increases the borrowing cost for the government and private businesses on the island. The current reform process happening in Puerto Rico under PROMESA presents an ideal opportunity to finally define the ultimate political future of Puerto Rico, and to begin a transition toward that end. Congress must act definitively to resolve Puerto Rico's future political status, because extending the failed 119-year-old territory status will only further delay the island's full economic, fiscal and demographic recovery. Congress must resolve Puerto Rico's status to unleash its full potential, and should implement the democratically expressed will of voters who have expressed twice in the last five years a clear desire to end the current territory status and to achieve statehood for Puerto Rico. Indeed, for America and Puerto Rico both, statehood is the best possible answer and the best path forward out of this century old issue and into a new century of economic growth and prosperity.

In closing, I want to thank GAO for its efforts in preparing this report. I hope that the comments contained here are helpful.

Sincerely,

A handwritten signature in blue ink, appearing to read "Carlos R. Mercader Pérez".

Carlos R. Mercader Pérez, Esq.  
Executive Director  
Puerto Rico Federal Affairs Administration



# Appendix III: Comments from the Government of American Samoa



LOLO M. MOLIGA  
GOVERNOR

OFFICE OF THE GOVERNOR  
AMERICAN SAMOA GOVERNMENT  
Telephone: (684) 633-4116 Fax: (684) 633-2269

LEMANU P. MAUGA  
LIEUTENANT GOVERNOR

August 15, 2017

Serial: 619

Susan J. Irving, Ph.D.  
Director for Budget Analysis  
Strategic Issues  
U.S. Government Accountability Office  
441 G Street N.W., Washington D.C.

Transmittal: Via Electronic Mail

Dear Dr. Irving:

The collaboration between my staff and the GAO Team lead by Ms. Divya Bali, Senior Analyst and her staff engaging in the Congressional directed task No. 101146, was seamless and effective in facilitating the compilation of a comprehensive final report on the public debt status of the American Samoa Government.

The objective inherent in the reporting parameters of factual information and the brevity of such information precluded discussion of issues compelling the American Samoa Government to utilize private sector options to access additional capital to finance its critical economic development infrastructure projects as it receives only \$10 million annually from the US Department of the Interior to meet social and economic development infrastructural needs.

The American Samoa Government since transfer of administrative responsibilities from the Department of the Navy to the Department of the Interior in 1951 has had its efforts to develop its economy stymied and stifled by prohibitive federal policies. These federal impediments are documented herein.

The Territory of American Samoa's economy is defined by just one industry engaged in the production of can tuna fish and other fish related products destined for the US Market. Withdrawal of federal incentives, automatic imposition of federal minimum wage hikes of \$0.40 every three years, prohibition of fishing in the high seas by NOAA, reduction of fishing grounds by Presidential Ocean Monuments expansion, grossly insensitive enforcement of United States Coast Guard rules and regulations, and stiff competition from foreign low wage can tuna fish producing foreign countries severely threaten the continued viability of this industry. StarKist Samoa is the only remaining company with the recent closure of Tri-Marine's Sam Tuna

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Appendix III: Comments from the Government  
of American Samoa

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Susan J. Irving, Ph.D  
August 15, 2017  
Page 2

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Processing in December 31, 2016 and the demise of Van Camp Samoa Packing Company in 2009.


American Samoa's economy is still going through recovery and the potential eminent loss of StarKist Samoa attributed to the above enumerated factors, will cause the Territory of American Samoa to emulate the financial crisis being experienced by the Territory of Puerto Rico and the Territory of the Virgin Islands. American Samoa will be at the Federal Government's doorstep requesting a bailout if our remaining fish cannery StarKist is forced to relocate its facilities to a low wage can tuna fish producing country.

The above discourse highlights American Samoa's total vulnerability due to its dependence on one industry (one company) and emphasizes the absolute need for economic diversification. Many of the island microstates in the Pacific are aggressively pushing the development of their tourism industries. American Samoa has struggled for a very long time to diversify its economy by developing its tourism industry. These efforts have been exercises in futility because the basic component of the tourism infrastructural system is air transportation. Regrettably, the federal "Cabotage Policy" created a monopolistic air transportation environment and placed American Samoa in a hostage situation subjecting visitors and residents alike to the payment of exorbitant airfares with only two flights a week except for the Summer and Christmas holidays.

The above factors impelled the American Samoa Government to explore other options including the bond issuance pathway. This option is also difficult to access because of our weak economy. Attraction of investment capital is effectively preempted by presence of impeding federal policies again compelling the American Samoa Government to increase its debt service structure.

The American Samoa Government's Debt Structure is the direct result of limited options available to access venture capital to build our economic development infrastructure. These factors should be considered in alignment with the debt service position of the Territory of American Samoa as well as the other Territories of the United States.

Sincerely,

  
Lolo M. Moliga  
Governor of American Samoa

c: Honorable Aumua Amata Radewagen, Member of Congress  
Honorable Ryan Zinke, Secretary, US Department of the Interior  
Honorable Nikolao Pula, Acting Assistant Secretary, Office for Insular Affairs

# Appendix IV: Comments from the Government of the Commonwealth of the Northern Mariana Islands



## COMMONWEALTH OF THE NORTHERN MARIANA ISLANDS

**Ralph DLG. Torres**  
Governor

**Victor B. Hocog**  
Lieutenant Governor

August 16, 2017

Mr. David Gootnick  
Director, International Affairs and Trade  
United States Government Accountability Office  
411 G Street, N.W.  
Washington, DC 20548

Dear Mr. Gootnick,

Thank you for the time and effort you have spent in drafting the report "U.S. Territories Public Debt Outlook." Its findings are vital to showcasing the ongoing progress that the Commonwealth of the Northern Mariana Islands (CNMI) has made toward its public debt—as well as its vast need for improvement—specifically regarding its primary government's net position. The CNMI appreciates the opportunity to be a part of the GAO's final report and hopes its contribution can assist in painting an accurate and forward-looking picture of the Commonwealth's current economic standing.

The GAO findings, as discussed in the draft, report that the CNMI's total public debt outstanding has declined from \$251.7 million in fiscal year 2005 to \$144.7 million in 2015. In a span of ten years, the CNMI has effectuated a decrease in its public debt by 42.5%. Per capita, the CNMI's total debt has declined by 33.8% from about \$4,199 per person in fiscal year 2007, to about \$2,776 in 2015. These numbers outline the CNMI's economic growth in the past decade and supports the Commonwealth's assertion that it is both financially prudent and secure.

As such, the CNMI aspires to sustain its economic viability outside of external debt. The draft report gives merit to the CNMI's steady increase in revenue after 2011 following the growth of its tourism industry. The report further supports a boost in CNMI tourism subsequent to the introduction of the CNMI gaming industry.

Although the CNMI's public debt has improved across the board with its Gross Domestic Product (GDP) increasing 3 years in a row since 2013, the GAO draft report notes that the Commonwealth faces growing labor shortages that are likely to affect our ability to repay future public debt.

In May 2017, the GAO report "Commonwealth of the Northern Mariana Islands: Implementation of Federal Minimum Wage and Immigration Laws" emphasized the CNMI economy's reliance on a foreign workforce. Due to the Consolidated Natural Resources Act of 2008's instrumental role in establishing federal control of CNMI immigration, the



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**Appendix IV: Comments from the Government  
of the Commonwealth of the Northern Mariana  
Islands**

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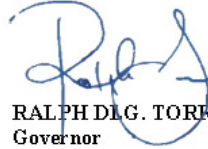
U.S. Department of Homeland Security (DHS) was required to establish a temporary work permit program for foreign workers in the CNMI. DHS also mandated a continual reduction in the annual number of permits issued until the end of a transitional period which is set to take place on December 31, 2019.

On that premise, the GAO predicts that with the removal of CW-1 status workers, the Commonwealth will suffer exponential economic decline. Specifically, GAO expects that the CNMI GPD in 2015 will diminish by 26 to 62%. The Commonwealth is geographically isolated from the U.S. mainland (5,500 miles in distance), making the recruitment and retainment of U.S. workers difficult. Concurrently, the CNMI's domestic work force, despite being at its highest since 2004, is incapable of providing the necessary labor to encompass the CNMI's developing industries.

Highlighting the drive behind the *Puerto Rico Oversight, Management, and Economic Stability Act* (PROMESA) which has executed this financial study of the territories, the CNMI wishes to express its concerns regarding the expected adverse impact of DHS's fast-approaching transition deadline. In hopes of avoiding a repetition of Puerto Rico's financial debt crisis, the Commonwealth requests for the United States Congress's serious consideration regarding the transition deadline and the CNMI's continued economic reliance on foreign labor. The Commonwealth can only continue to make debt service payments and advance its financial standing, therefore its bond ratings, if the economy continues to grow toward financial sustainability. This result is completely dependent on the federal government's support of a foreign workforce in the CNMI.

Thank you again for your hard work and diligence in putting this report together. I appreciate GAO's willingness to work collaboratively with the CNMI to produce a precise and detailed work product for implementation in the territories' financial planning processes. The discussed data is essential to the CNMI's self-assessments as well as our goal of enhancing the Commonwealth's financial standing in the coming years. I anticipate that the final report will assist us in meeting this objective. Likewise, I am hopeful that this report will shed light on the CNMI's dire need for Congressional action in order to prevent the devastation of another United States territorial economy.

Sincerely,



**RALPH D. G. TORRES**  
Governor

# Appendix V: Comments from the Government of Guam



**EDDIE BAZA CALVO**  
Governor

**RAY TENORIO**  
Lieutenant Governor

*Office of the Governor Of Guam.*

September 14, 2017

Susan J. Irving, Ph.D.  
Director for Federal Budget Analysis  
Strategic Issues  
U.S. GAO  
441 G Street, N.W., Washington DC 20548  
[irvings@gao.gov](mailto:irvings@gao.gov)  
[202-512-8288](tel:202-512-8288)

Subject: Guam's Response - GAO Review of Territorial Debt Draft for Comment Guam

Dear Dr. Irving,

*Hafa Adai!* Thank you for the opportunity to review Guam's section of the draft report, *U.S. Territories Public Debt Outlook*, GAO's review of territorial debt, as well as to provide my Fiscal Team's comments and the GAO's incorporation of corrections based upon our review. It is imperative that Guam is represented accurately in these types of reports which should reflect the successes we have achieved in my Administration's efforts to improve the lives of the People of Guam as a whole, with emphasis on our financial condition. Listed below are our comments on the draft report after the GAO's revisions based upon our discussions on the matter.

## Policy and General Comments:

- I would like to begin with a policy statement regarding the Government of Guam's calculation of our baseline Debt per Capita, we calculate all of Guam's debt supported by taxes *excluding* public enterprise or revenue bonds issued by the Guam Waterworks Authority (GWA), Guam Power Authority (GPA) and the A.B. Won Pat Guam International Airport Authority (GIAA). When measured this way, as is the practice in the Municipal Finance Market, tax supported debt truly reflects the core of Guam's outstanding obligations. Additionally, the Government of Guam assumes many functions that in the states are handled by other entities, such as school districts, cities, counties and transportation districts.
  - Guam has only "state" level debt and no local debt.
  - Guam does not pay federal taxes that support the federal debt; therefore, it does not have overlapping federal debt above it either.

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Eddie Baza Calvo



@eddiebazacalvo



@governorcalvo



governorofguam

See comment 1

See comment 2

See comment 3

See comment 4

See comment 5

See comment 6

See comment 7

- Guam's actual debt burden per capita is actually among the lowest in the country when considering local debt, and this holds true even after adding pension liabilities.

- Although the report states that the revenues reported for territories include the primary government as well as the component units, total revenues appear to reflect only general government (tax supported) and not the enterprise funds, which, if true, would definitely fall into the "apples-and-oranges" category since debt levels appear to reflect enterprise fund debt (e.g., GWA, GPA, GIAA).

**Total Public Debt Outstanding:**

- Page 11: Details should be provided on how the Total Public Debt Outstanding for fiscal year 2015 is determined at \$2.5 billion. This is the basis for determining the accuracy of the other ratios contained in this report. Moreover, it would be prudent to identify the amount of debts from the primary government separately from those of the component units with the corresponding component unit revenue added in.
- Page 11. Bonded debt outstanding as a percentage of total public debt. The report states between 93 and 97%. However, based on the table below, it is 85% if we combine Primary Government and Component Units (Numbers are from the FY2015 audit, page 17). Thus, the further need to understand how the Total Public Debt was calculated for this report.

	Primary Government	Component Units	Total
Noncurrent Liabilities	2,215,916,988	1,765,351,586	3,981,268,574
Less pensions	(846,150,680)	(396,406,981)	(1,242,557,661)
Noncurrent Liabilities w/o Pension Liabilities	1,369,766,308	1,368,944,605	2,738,710,913
Bonds Payable, net of current portion	1,105,756,698	1,230,237,153	2,335,993,851
	81%	90%	85%

- As noted in the report, Guam's revenue grew an average of 5% a year. Therefore, this should be a positive note to Guam's ability to cover its debt service with revenue and not just focus on the fact that the debt is increasing. The point, which is Guam's continuing ability to pay its debt, seems to be missing from the report.

**Public Debt as a Share of GDP**

- Page 12. Total public debt outstanding as a share of GDP is reported to have increased from 24 percent to 44 percent between fiscal years 2005 and 2015. However, using Guam's actual debt as of March 31, 2017 of \$1.102 billion

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Eddie Baza Calvo



@eddiebazacalvo



@governorcalvo



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(<http://www.investguam.com/public-finance-opportunities/guam-bond-information/>), this number should be just around **19 to 21 percent**, depending on the GDP number used.

Gross Domestic Product (GDP)	\$5.734 billion
Bonded Debt	\$1,101,920,045
	<b>19.2%</b>

Real GDP, Chained Dollars	\$5.166 billion
Bonded Debt	\$1,101,920,045
	<b>21.3%</b>

See comment 8

- In a recent Reuters article titled *Shunned from bond market, U.S. Virgin Islands faces cash crisis* (<http://www.reuters.com/article/us-usa-virginislands-crisis-idUSKBN1AI0D2>), a similar calculation was made to show how the U.S. territories rank with regard to their debt as a percentage of GDP, as well as their per capita ranking. The source of the charted information is Moody's Investor Services. Please take some time to review such to see how these figures were calculated. **Guam's "net tax-supported debt" as a percentage of GDP is reported at 21.5%.**

#### Public Debt Per Capita

- Page 12. Public Debt Per Capita. The numbers presented in the report do not match the FY2015 audit.

Debt per Capita:	
Total Public Debt per Capita	\$15,323
Population	162,000
Total Public Debt	\$2,482,326,000
Bonded Public Debt per Capita	\$14,759
Population	162,000
Bonded Public Debt	\$2,390,958,000

See comment 9

See comment 10

- Based on the Government of Guam's calculations, the **debt per capita is \$6,811**. This is calculated using Guam's actual debt as of March 31, 2017 of \$1.102 billion (<http://www.investguam.com/public-finance-opportunities/guam-bond-information/>), and 2015 population figure of 161,785. With the inclusion of the Net Pension Liability of \$846 million, the debt per capita would be \$12,041. In both scenarios, our calculated debt per capita is lower than what is reflected in the report.

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@eddiebazacalvo



@governorcalvo



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Debt per Capita	\$6,811
Population	161,785
Bonded Debt	\$1,101,920,045
Debt per Capita	\$12,041
Population	161,785
Bonded Debt + Net Pension Liability	\$1,948,070,725

- As mentioned in the previous section, Reuters published an article which included a comparison of U.S territories' debt loads. In this report, Guam is reported to have a "net tax-supported debt" per capita of **\$7,639**, which is again, significantly lower than what is in the draft report at \$14,759 and \$15,323.

**Other comments:**

- The report appears to be presented negatively and did not highlight positive things that have been accomplished. As an example, on page 17, it indicates "Despite Guam's Recent Economic Growth, Growing Pension Fund Liabilities May Present a Risk".
  - Guam is meeting the actuarial contribution on an annual basis and we are on target to pay off our obligation in approximately 15 years, the tourism sector has tremendous potential growth and our General Fund revenues have increased thus bolstering Guam's continued ability to pay debt service and fund essential government services such as public health, education and public safety.

Once again, thank you for the opportunity to present our comments and for the incorporation of many of our concerns into the drafting of your final report.

Senseramente,



EDDIE BAZA CALVO

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Eddie Baza Calvo



@eddiebazacalvo



@governorcalvo



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See comment 11

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The following are GAO's comments on Guam's letter that supplement the comments in the text.

**GAO Comments**

1. Our responses to Guam's technical comments are not corrections. After reviewing Guam's comments, we expanded the information provided on revenue and net position for all 5 territories. For example, for Guam, we included on pages 41 and 42 of this report, additional information on revenue where we combine primary government revenue and component unit revenue.
2. Since our objective was to provide the most comprehensive metric of total public debt, it would have been incorrect for us to exclude public enterprise and revenue bond debt in our measure.
3. We do not compare the relative public debt burdens of the territories in this report. Further, pension liabilities are not included in our definition of public debt. Our definition of total public debt does include component unit debt, which Guam excludes from the calculations presented in its response.
4. On pages 41 and 42 of this report we include both a measure of primary government revenue, and a measure of primary government revenue and component unit revenue combined; an "apples-to-apples" comparison can be made to our total public debt figure, which includes component unit debt.
5. Our calculation of total public debt outstanding for Guam is the total of bonds payable and notes payable, both the current and noncurrent portions, and other debt as defined on page 8 of this report. Guam's calculation of total public debt outstanding as shown in the table is all noncurrent liabilities except the net pension liability and results in a higher amount for fiscal year 2015 than our calculation. For bonds payable, our calculation includes both the current and noncurrent portions of bonds payable. Guam's calculation of bonds payable as shown in the table only includes the noncurrent portion and results in a lower amount for fiscal year 2015 than our calculation. As a result of these differences, our calculation of bonded debt outstanding as a percentage of total public debt outstanding for fiscal year 2015 is higher than Guam's calculation.
6. As noted on page 42 of this report, while revenue generally grew, Guam's net position for the primary government fluctuated significantly between fiscal years 2005 and 2015. Since fiscal year end 2006, Guam's net position for the primary government has been

negative and trending downward. Guam's total net position for the primary government and component units also combined fluctuated significantly. On page 41 and 42 of this report, we explicitly note the increase in revenue, however in the long-term significant financial risks may outweigh any given year's revenue increase.

7. Based on our methodology, which includes component unit debt, Guam's total public debt outstanding was \$2.5 billion for fiscal year 2015.
8. We used total public debt outstanding, not solely tax-supported debt to calculate the debt-to-GDP ratio for all 5 territories. As reported on page 39 of this report, Guam's debt to GDP ratio is 44 percent for total public debt and 42 percent for bonded debt for fiscal year 2015. We do not rank the U.S. territories in this report.
9. The per capita amounts presented in the report are based on debt amounts from Guam's fiscal year 2015 audit as reported in the single audit report. However, the debt amounts and population figure shown in the table differ from those used in our calculations. Total public debt and bonded public debt outstanding used in our per capita calculations are calculated as discussed in comment 5 above, which differ by about \$7 million from the amounts cited in the table. In addition, the population figure used in our per capita calculations is on a fiscal year basis, which results in 161,500 for fiscal year 2015.
10. Pension liabilities are not included in our definition of public debt. The debt per capita numbers that we present in this report are based on total public debt. For Guam that figure for fiscal year 2015 was \$2.5 billion.
11. We disagree with Guam's comment that the presentation in this report is negative. The final section in the discussion of Guam notes both the elements that may contribute to continued economic growth in Guam and the vulnerabilities and risks to the future: a high total debt burden and vulnerability to economic changes in its tourism and military industries. In addition, we note that Guam has large pension and other post-employment benefits liabilities that may stress current debt service payment arrangements if anticipated savings from changes to the government pension system are not realized.



# Appendix VI: Comments from the Government of the United States Virgin Islands



## THE UNITED STATES VIRGIN ISLANDS

OFFICE OF THE GOVERNOR  
GOVERNMENT HOUSE

Charlotte Amalie, V.I. 00802  
340-774-0001

August 15, 2017

Ms. Tara Carter  
Assistant Director for Federal Budget Analysis–Strategic Issues  
U.S. Government Accountability Office  
441 G St., NW  
Washington, DC 20548  
[cartert@gao.gov](mailto:cartert@gao.gov)

Dear Ms. Carter:

Thank you, and the Government Accountability Office (“GAO”) team, for the opportunity to provide comments on the draft report entitled *U.S. Territories: Public Debt Outlook* (GAO-17-689). The Government of the Virgin Islands (“the Government”) appreciates your time and efforts in this process.

The Government’s comments below provide additional information relevant to the third topic addressed in the report—“the major reported drivers of public debt” (Draft Report, p. 2.). The major driver of public debt of the Government is budget deficits, as referenced in the draft GAO report. The budget deficits are attributable in large part to the fact that the Virgin Islands and other Territories are not treated equally with States under most federal programs and thus receive substantially less federal funding than States. The difference in federal funding, including matching rates, under these programs must be subsidized with local funds to provide the same service or benefit to our citizens. From year to year, this has placed—and continues to place—a substantial burden on the local treasury.

Federal healthcare funding is a leading example. As opposed to how the Medicaid program works in the States, where it is a federal entitlement program, Medicaid funding for the Virgin Islands is capped at an arbitrary amount that has no relationship to the medical needs of the Territory’s Medicaid population. This capped funding is unrelated to Territorial medical cost changes from year to year, even though our citizens must access quality care. Further, the Federal Matching Rate (“FMAP”) for the Virgin Islands is arbitrarily capped by statute at 55%, even though the Virgin Islands would qualify for an FMAP rate of 83% if the Territory were treated equally with States. The arbitrarily low FMAP—and corresponding high local match rate—has forced the Virgin Islands Government to spend more local Medicaid dollars than a State. A State-like FMAP alone would provide the Government hospitals approximately \$22 million per year in local matching funds and concomitantly reduce our uncompensated care cost and subsidy from the local treasury.



*Letter to Assistant Director Tara Carter  
August 15, 2017  
Page 2*

In addition, the Territory's two hospitals, which are publicly-owned, are excluded from the Medicaid and Medicare Disproportionate Share Hospital ("DSH") programs in spite of the significant amount of uncompensated care provided by the hospitals. What is ironic by this exclusion is the fact that our hospitals are precisely the type of hospitals for which the DSH programs were created. If the Territorial hospitals were treated as State-side hospitals, they would receive several million dollars per year in DSH funding.

Further, the hospitals in the Virgin Islands are compensated under Medicare using out-of-date TEFRA reimbursement formulas—even though Virgin Islanders pay the same Medicare taxes as residents on the U.S. mainland. The hospitals' base years are 1982 and 1996, which result in inadequate compensation compared to the mainland. The cost to the Government of this under-reimbursement alone is not less than \$10 million per year. Moreover, the outdated federal reimbursement schedules prevent the hospitals from offering many necessary services such as total joint replacement and expensive chemo treatments, requiring Virgin Islanders to travel outside the Territory for such services. In addition, because the Virgin Islands does not have a healthcare insurance exchange, and there is no viable private healthcare insurance market for individuals, the Territory has a high percentage of uninsured compared to the mainland. As a result, the Government must provide approximately \$22 million to each hospital—or a total of \$44 million to both hospitals—in local funds each year.

Other mandatory federal programs impose substantial additional burdens on the Territory's finances. The federal Earned Income Tax Credit ("EITC") is intended to encourage work among low-income individuals. In the United States, the federal government effectively funds this program for all States and the District of Columbia ("DC") through the Internal Revenue Code. While a worthy goal, this federal tax credit has unintended and unfair consequences in the Virgin Islands due to the Territory's status as a mirror tax code jurisdiction. Under this mirror system, the income tax liability of residents of our Territory is determined by reference to the income tax laws of the U.S. Consequently, unlike the States and DC, the cost of the EITC—approximately \$20 million per year—is borne solely by the fiscally-stressed Territorial Government, a cost which we cannot continue to bear. Similarly, the cost of the Child Tax Credit (CTC) for families with one or two children—approximately \$7 million per year—is also borne by the Territory.

Finally, in many federal programs in which funding is determined by a formula, the Virgin Islands and other territories are treated less favorably than States. For example, the Virgin Islands and other territories receive much less federal highway funding than they would receive if they were States. The difference is made up by the local treasury at a cost of millions of dollars per year.

The foregoing costs to the Government have been generally covered by borrowing for operating expenses. From year to year, these costs are attributed to our annual budget deficits because these are costs that exceed revenues. In short, if American citizens living in the Territories were treated on a par with the States, the Virgin Islands could significantly reduce its budget deficits, and could have avoided a great percentage of borrowing for operating expenses. On December 20, 2016 a Congressional Task Force on Economic Growth in Puerto Rico, Report to the House and Senate, 114th Congress at pages 16-30 came to a similar conclusion.

*Letter to Assistant Director Tara Carter  
August 15, 2017  
Page 3*

I want you to know that I am committed to achieving fiscal balance for the Government of the Virgin Islands and to addressing the unfunded liability of the Government Employees Retirement System. However, I must also point out that it is vitally important that the GAO take into full consideration all of these factors I have addressed herein when issuing its final report. Such consideration of what truly constitutes the driving causes for the Government's debt will ensure that a full and accurate picture is presented to the public and financial markets.

Once again, thank you for your time and cooperation during this process.

Sincerely,  
  
Kenneth E. Mapp  
Governor

cc: Divya Bali, Analyst-in-Charge, GAO  
[balid@gao.gov](mailto:balid@gao.gov)

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# Appendix VII: GAO Contacts and Staff Acknowledgments

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## GAO Contacts

Susan J. Irving, (202) 512-6806, [irvings@gao.gov](mailto:irvings@gao.gov)  
David Gootnick, (202) 512-3149, [gootnickd@gao.gov](mailto:gootnickd@gao.gov)

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## Staff Acknowledgments

In addition to the contacts named above, Tara Carter, Assistant Director; Emil Friberg, Assistant Director; Divya Bali, Analyst-in-Charge; and Steven Berke, Karen Cassidy, and Eddie Uyekawa made significant contributions to this report. Dawn Simpson, Director; Nicole Burkart, Assistant Director; and J. Mark Yoder provided accounting expertise. Also contributing to this report were Pedro Almoguera, Jeffrey Arkin, Ann Czapiewski, John Hussey, Heather Krause, Donna Miller, Amy Radovich, Justin Snover, and A.J. Stephens.

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Katherine Siggerud, Managing Director, [siggerudk@gao.gov](mailto:siggerudk@gao.gov), (202) 512-4400, U.S. Government Accountability Office, 441 G Street NW, Room 7125, Washington, DC 20548

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## Public Affairs

Chuck Young, Managing Director, [youngc1@gao.gov](mailto:youngc1@gao.gov), (202) 512-4800, U.S. Government Accountability Office, 441 G Street NW, Room 7149, Washington, DC 20548

---

## Strategic Planning and External Liaison

James-Christian Blockwood, Managing Director, [spel@gao.gov](mailto:spel@gao.gov), (202) 512-4707, U.S. Government Accountability Office, 441 G Street NW, Room 7814, Washington, DC 20548



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